REPORT

ON

THE LAW OF MORTGAGES

ONTARIO LAW REFORM COMMISSION

Ontario

Ministry of the
Attorney
General

1987

The Ontario Law Reform Commission was established by the *Ontario Law Reform Commission Act* for the purpose of reforming the law, legal procedures, and legal institutions. The Commissioners are:

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*Mr. Earl A. Cherniak, QC, Dean J. Robert S. Prichard, and Mrs. Margaret A. Ross joined the Commission at a time when this Report was very near completion and almost all the recommendations had been made.

The Commission wishes to acknowledge the critical contribution of three former Commissioners: Hon. Richard A. Bell, PC, QC, LLD, Mr. William R. Poole, QC, and Mr. Barry A. Percival, QC, whose tenure at the Commission extended through most of this Project.

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Ontario
Law Reform
Commission
Ontario

The Honourable Ian G. Scott, QC
Attorney General for Ontario

Dear Mr. Attorney:

We have the honour to submit herewith our *Report on the Law of Mortgages*.

CHAPTER 1

GENERAL INTRODUCTION

1. BACKGROUND OF THE PROJECT

(a) THE COMMISSION'S LAW OF PROPERTY PROJECT

In the Ontario Law Reform Commission's first *Annual Report*, in 1967, attention was drawn to the "general agreement that a thorough review of the law of property, with particular emphasis on the law relating to interests in land, is overdue in this jurisdiction".[1] Animated by a firm conviction that what was necessary was an all-embracing law of property code, which, among other things, would abolish existing anachronisms, simplify conveyancing procedures, and assimilate the law of real and personal property, the Commission initiated its Law of Property Project.

This comprehensive long term Project was initially divided into ten discrete, although related, areas. Most of the topics, concerning, for example, condominiums, landlord and tenant, land registration, development control, and trusts, have already been examined and form the subject of several Commission Reports.[2] Reports on other related topics, including basic principles of land law, are now in the final stage of preparation.

From the inception of the Law of Property Project, the Commission's study of the law of mortgages was seen as an integral component of that broader review. Not only did the topic fit naturally into the larger mould, but, as we shall see,[3] a number of oral and written comments, directed to the Commission, had alerted it to many deficiencies in the existing law of mortgages. It appeared at that time that the then current law and practice were not operating in an efficient and fair manner. Subsequent events have not caused us to alter this initial perception.

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[1] Ontario Law Reform Commission, *Annual Report 1967* (1968), para. 67, at 18.

[2] See the following Reports of the Ontario Law Reform Commission: *Report on the Law of Condominium* (1967); *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies* (1968); *Report on Review of Part IV, The Landlord and Tenant Act* (1972); *Report on Landlord and Tenant Law* (1976); *Report on Land Registration* (1971); *Report on Development Control* (1971); and *Report on the Law of Trusts* (1984).

[3] See *infra*, this ch., sec. 2.

(b) THE CONDUCT OF THE PROJECT

While, as we have said, the Project on the Law of Mortgages formed an integral part of the Commission's study of the law of property, work on the Project was deferred for some time due to the pressure of other commitments undertaken by both the Commission and those who were to be involved in setting forth a research design and in conducting a detailed examination of mortgage law. However, in October 1981, the Commission reactivated the Project. It engaged the services of Barry J. Reiter, Esq., then Associate Professor of Law at the Faculty of Law, University of Toronto, and now in the private practice of law in Toronto, to act as Director of the Project.

The Project proceeded in three stages. The Commission recognized that, in order to evaluate critically the present law and practice in the mortgage field, it was essential to rely upon the experience and expertise of those persons actively involved in, or directly affected by, mortgage transactions. Accordingly, during the first stage, we invited borrowers, lenders, lawyers, and others to submit letters or written briefs concerning perceived problems respecting such transactions. In addition, Mr. Reiter engaged in a round of preliminary discussions with selected representatives of all sectors of the community affected by mortgage law. These discussions were held with representatives of lenders of all sizes (ranging from banks and trust companies through private second mortgage lenders), mortgage brokers, consumers' associations, government officials, and lawyers. The purpose of these discussions was to compile a comprehensive list of issues that it was thought should be reviewed as part of the Law of Mortgages Project. In light of the comments received, Mr. Reiter prepared an Issues and Agenda Report, identifying issues and problems that had been conveyed to him and suggesting a Project format to review the merits of those concerns and the manner by which they might be ameliorated. The Issues and Agenda Report was subsequently reviewed and accepted in principle by the Commission.

As a further measure to ensure that the Commission received both theoretical and practical advice crucial to effective law reform, a Research Team and an Advisory Board were appointed. The Research Team was engaged to conduct research on a broad range of topics and to formulate tentative recommendations for reform; the Advisory Board, made up of mortgage experts of diverse interests and associations, was to be available for consultation concerning the tentative proposals of the Research Team and Project Director.

During the second stage of the Project, members of the Research Team prepared papers on matters identified in the Issues and Agenda Report that appeared to be in need of reform. The papers examined the various claims for the need for reform and proposed broad alternative directions for reform where it was thought to be warranted. In preparing their research papers, members of the Research Team met with members of the Advisory Board and others active in the mortgages area to elicit comment and to test proposals. The research papers were considered at the end of 1982 by the Advisory Board, and the Project Director prepared an interim report for the consideration of the

Commission. The Ontario Law Reform Commission approved in principle most of the reform directions that were proposed in the Director's Report.

Thereafter, during the third stage, the Research Team prepared a more detailed series of research reports focusing on the manner in which the reform proposals, formerly framed in more general terms, could be implemented. These reports were prepared over the course of 1983. Simultaneously, the Project Director released to a number of associations and persons interested in mortgage law a statement outlining the directions in which he perceived that the Project would proceed. The statement asked for comments on the proposals. Over the course of 1983, a substantial number of comments was received. As well, the Director and certain members of the Research Team were asked to meet with various individuals and associations, and to speak to meetings of these associations, in order to outline the general nature of the reforms that were being considered. Additional comments were received from a wide variety of sources. All comments were considered by the Research Team and the individual researchers as the revised research reports were being prepared.

The revised and more detailed reports were presented for the consideration of the Advisory Board at meetings held at the end of 1983. On the basis of those revised research reports and the comments of members of the Advisory Board, the Project Director prepared a Director's Final Report, which was submitted to the Commission in early 1984.

The Commission considered the detailed recommendations for reform at meetings during the spring of 1984. Thereafter, members of the Research Team were asked to prepare a draft Act that would incorporate the Commission's specific reform recommendations. Members of the Research Team were also requested to continue research on a number of issues that arose out of the Commission's consideration of the Project Director's Final Report. This process raised a number of new issues and, ultimately, further research reports and a draft Act were prepared and then submitted for the consideration of the Advisory Board in late 1984. The Project Director produced a further report on these issues, which was dealt with by the Commission in early 1985.

From the foregoing description of the initiation, conduct, and progress of the Law of Mortgages Project, it should be clear that a fundamental concern of the Commission has been to ascertain the views of those directly affected by mortgage law and practice. The manner in which the Project has been pursued gives the Commission confidence that these views, as well as the views of academics teaching in the area, have been canvassed and assimilated.

The Commission wishes to express its gratitude to the Director of the Project, Barry J. Reiter, Esq., Barrister and Solicitor, Toronto, Ontario, for his invaluable contribution throughout the three stages of our study. His knowledge of the often difficult area of mortgage law, as well as his organizational abilities and enthusiasm, are reflected in the Commission's Report.

We also wish to record our appreciation to the members of the Research Team, who prepared research papers for the Commission and who met with the Project Director and others to consider the proposals contained in those papers. The Research Team included Eric Gertner, Esq., Barrister and Solicitor, Toronto, Ontario; John B. Laskin, Esq., Barrister and Solicitor, Toronto, Ontario; Professor S.M. Makuch, of the Faculty of Law, University of Toronto; Professor Richard H. McLaren, of the Faculty of Law, University of Western Ontario; Professor John Swan, of the Faculty of Law, University of Toronto; and Professor T.G. Youdan, of Osgoode Hall Law School, York University.

The Commission acknowledges, with thanks, the substantial contribution of the members of the Commission's Advisory Board, who gave generously of their time and energy in meeting with the Project Director and the Research Team. The Advisory Board comprised the following persons: Ms. Helen Anderson, Consumers Association of Canada, Toronto, Ontario; Frank Bennett, Esq., Barrister and Solicitor, Toronto, Ontario; Brian D. Bucknall, Esq., Barrister and Solicitor, Toronto, Ontario; William Clarkson, Esq., Vice-President — Mortgages, Toronto Dominion Bank, Toronto, Ontario; Professor Allison Dunham, Institute of Law Research and Reform, Edmonton, Alberta; Robert M. Keller, Esq., Vice-President, Corporate and General Lending, Victoria & Grey Trust Company, Toronto, Ontario; Arthur Kennedy, Esq., Q.C., Barrister and Solicitor, Toronto, Ontario; Peter Lauwers, Esq., Barrister and Solicitor, Toronto, Ontario; Ralph H. Lewis, Esq., Province of Ontario, Ministry of Consumer and Commercial Relations, Business Practices Division, Toronto, Ontario; Paul D. Mazza, Esq., Barrister and Solicitor, Hamilton, Ontario; Douglas C. McTavish, Esq., Barrister and Solicitor, Toronto, Ontario; Donald D.W. Milne, Esq., Barrister and Solicitor, Toronto, Ontario; Milton J. Mowbray, Esq., Q.C., Barrister and Solicitor, Toronto, Ontario; A.M. Rock, Esq., Q.C., Barrister and Solicitor, Toronto, Ontario; Nick Scarfo, Esq., Traders Group Ltd., Toronto, Ontario; Martin Stambler, Esq., Q.C., Barrister and Solicitor, London, Ontario; and Charles H. Style, Esq., Barrister and Solicitor, Barrie, Ontario.

In particular, we wish to acknowledge the outstanding contribution of Peter Lauwers, Esq., particularly in the drafting, through several versions, of the Commission's proposed *Land Security Act*.

The Commission wishes to express its appreciation to the many other persons who submitted written comments on problems in the law of mortgages or who met with the Project Director and other Commission representatives to discuss various aspects of mortgage law and practice. The quality of our recommendations is due in no small measure to such individuals.

Finally, we wish to thank Mr. M.A. Springman, Senior Legal Research Officer, and Ms. Judith Bellis, Legal Research Officer, for their dedication in bringing our Report to a successful conclusion, and to Ms. M. Patricia Richardson, Counsel to the Commission, for her invaluable contribution in the editing of this Report.

2. THE NEED FOR REFORM

It is important to emphasize at the outset that the general consensus of those persons with whom we consulted was that the current law of mortgages was not completely unworkable; virtually no one was of the opinion that the existing system was intolerable and, therefore, warranted wholesale reform. On the other hand, almost everyone believed that there were specific areas in respect of which reform would be desirable. Their concerns may be grouped around four major issues.

First, there was a general sense that mortgage remedies did not effect a proper balance between the expeditious and efficient recovery of the debt by lenders and the protection to be given to the legitimate interests of borrowers. It was generally believed that existing procedures offered opportunities for both delaying legitimate realization procedures and overreaching on the part of lenders.

Secondly, there was a concern that the law of mortgages was "diffuse", in the sense that its various component parts were unintegrated and not easily accessible to lawyers, lenders, borrowers, and others interested in the area. The law of mortgages is an amalgam of common law and equitable principles, and is affected in many respects by several statutes. There was a general belief that the law of mortgages would benefit by being centralized and rationalized, so far as it was feasible and desirable to do so, in a single statute.

Thirdly, concern was expressed about a number of specific substantive problems, in respect of which it was thought either that the law had made inappropriate choices in the first instance, or that initially justifiable choices had been overtaken by the facts of modern mortgage financing. Reform was suggested for a number of specific matters, ranging from general policy questions (such as the rights of residential tenants under a lease executed subsequent to a mortgage) to specific technical legal issues (such as the nature and appropriateness of the doctrine of "clogs on the equity of redemption").

Finally, there was a growing recognition that a distinction ought to be made between "consumer" and "commercial" mortgages. There was a general belief that, in many respects, these mortgages had little in common other than that land was being used as security for the debt. The issues in respect of which it was thought that a distinction between consumer and commercial mortgages might be legitimate ranged from disclosure obligations on lenders, through substantive rights (such as prepayment of the debt) and remedies (such as the power of sale).

The Commission has considered all of the areas in respect of which reform was proposed, either by those experts whom we consulted or who offered suggestions, or by the Research Team. The recommendations made in this Report affect almost all aspects of mortgage law. In some cases, our recommendations reflect an existing practice that, in our view, manifests desirable advances on the strict legal position. In other cases, our recommendations give clear support to hitherto hesitant developments in the law that might, but yet might not, ultimately reach fruition through the evolution of judge-made law or through the assimilation of mortgage law to secured credit law generally, and specifically to the *Personal Property Security Act*.[4] Finally, in several areas, we have attempted to introduce innovations that find their inspiration from sound principles of public policy, rather than from existing practice or recent developments.

On the other hand, our recommendations leave untouched several areas of mortgage law, including some areas in respect of which reform was recommended by persons consulted by the Commission. In succeeding paragraphs we shall comment generally on the reasons why, in some cases, existing law, or a very slight deviation from it, was preferred. The volume of the comments and suggestions that we received makes it impossible to list all of the recommendations offered to us and the reasons that have led us not to recommend reform in some areas. Suffice it to state that, where a particular facet of mortgage law or practice has not been mentioned in this Report, it should be assumed that no reform was thought to be warranted in that area.

Our decisions to recommend reform or not to do so, and our choices of specific reform proposals, have been informed by three fundamental principles. First, the competitiveness of the mortgage marketplace gives us confidence that a wide variety of choice will continue to be made available to those seeking mortgage financing. Innovation is a fact of life in such financing and is, in our view, a desirable fact. Accordingly, we believe that the nature of mortgage transactions should, so far as is possible and just, be left to the market.

Secondly, we recognize that, notwithstanding the relative openness and competitiveness of the mortgage marketplace, that marketplace is by no means a "perfect market" in the economists' sense. In particular, the marketplace is characterized by high transaction costs and significant differentials of knowledge and experience as between lenders, on the one hand, and borrowers (particularly non-commercial borrowers), on the other. While interference with the environment within which mortgage transactions are arranged should be undertaken cautiously, there should be no fear of interference where adequate justification exists. The fact that this interference might increase the costs of mortgage financing should not, in itself, deter reform of the law where the benefits of such action are perceived to outweigh the costs.

Thirdly, we are acutely aware of the problems of legislated change and, particularly, of radical legislated change. Mortgage law includes much law of great antiquity. As we have said, this law is often complicated by its "layered" nature, in the sense that, in many ways, equity mitigates the rigours of the common law and, as well, statutes may affect both. There is considerable interrelationship among the various aspects of mortgage law and it is very often not possible to address a single problem without having significant, and perhaps untoward, consequential effects in other areas. As well, we are sensitive to the recurrent theme expressed by those with whom we consulted, namely, that existing mortgage law and practice are, to a large extent, operating satisfactorily. It is no simple task to formulate legislative solutions that can anticipate, and address effectively, practical problems that can be created by well-meaning reform endeavours.

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[4] R.S.O. 1980, c. 375.

We recognize that, in the nature of things, any new legislation is likely to fail to anticipate all of its ramifications and will require at least some clarification by further legislation or litigation. This ought not to be an excuse for abstention where change is needed, but rather a counsel of moderation with respect to legislated law reform. This point has led us to consider the impracticability of detailed legislation in many of the areas in respect of which reform was proposed to us. Our wish is for a workable, as well as equitable, regime governing the law of mortgages. Both are integral component parts of effective law reform.

Nevertheless, as we have discussed, we believe that the law of mortgages, which is currently affected by many statutes as well as by an amalgam of common law and equitable principles, would benefit by being centralized and rationalized, so far as possible, in a single statute. Accordingly, we recommend that a new *Land Security Act* should be enacted and that all substantive rules governing security interests in land should be included in that Act.[5]

3. AN OVERVIEW OF THE REPORT

The recommendations for reform proposed in this Report cover a broad range of issues. Accordingly, it seems desirable in this section to provide a general overview of the topics canvassed.

In chapter 2, we shall describe various types of land security interest prevalent in Ontario. The Commission's recommendations would result in the enactment of a new *Land Security Act*, which would apply not simply to "mortgages", narrowly defined, but to every transaction, regardless of its form, that is intended to create a security interest in land.

In chapter 2, the Commission will also consider the creation and nature of a security agreement, bearing in mind the change in its legal form from a transfer of an estate in land to a mere charge on land.[6] We shall then propose the establishment of certain minimum requirements for the enforceability of security agreements.

In chapter 3, we shall deal with such anomalies and anachronisms as the doctrines of consolidation, tacking, and clogs on the equity of redemption.

In chapter 4, the Commission will turn to consider the legal trend towards consumer protection legislation for financially unsophisticated borrowers. We shall recommend the creation of a class of "protected borrower", in respect of whom special rights would be conferred. A borrower would be a protected borrower if he or she occupied all or part of the secured property as a residence, or if he or she resided on certain kinds of property not exclusively residential in nature, where such premises secured a loan that did not exceed a specified amount. Other persons, such as a guarantor of a loan secured in the above manner, or the spouse of a protected borrower, would also be given the proposed protections.

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[5] See *infra*, Appendix 1.

[6] *Land Registration Reform Act, 1984*, S.O. 1984, c. 32, s. 6(1).

In chapter 5, the Report will deal with priorities among lenders. We shall discuss priority for future advances made pursuant to the security agreement, as well as for advances made to protect or complete the property. Priorities upon renewal of a security agreement will also be reviewed.

In chapter 6, the Commission will examine the borrower's right to prepay the loan, to receive a discharge of the security agreement upon satisfaction of the loan obligation, and to be provided with a statement of account. Recommendations will be made regarding a lender's liability for damages that arise from reliance on an incorrect statement of account by either a borrower or a third party.

Chapter 6 will also deal with due-on-sale, due-on-encumbrance, and due-on-negotiation clauses. Finally, we shall consider matters relating to insurance of the secured property, including the amount of insurance coverage that a borrower can be required to obtain and the use to which the insurance proceeds may be put.

The discussion in chapter 7 will centre on the needs of a borrower to obtain adequate information from the lender at various stages of the loan transaction, such as the advertising or first inquiry stage, the commitment stage, and the execution stage. The use of "plain language", both in disclosure statements and in security agreements, will be dealt with in this context.

In chapters 8, 9, and 10, the Commission will consider the rights and remedies of borrowers and lenders upon default. Chapter 8 will examine the efficacy of judicial sales, extra-judicial sales, and foreclosure as means of realizing the lender's security interest. The Commission will examine the extent to which a defaulting borrower should be afforded an opportunity to reinstate the security agreement, refinance the loan, or sell the secured property. The Report will also offer proposals concerning the appropriate standard of care required of a lender in realizing his or her security interest.

In chapter 9, the Commission will discuss the lender's right of action on the borrower's personal covenant to pay the secured debt. We shall also deal with the rights of the parties where a borrower seeks to transfer the property subject to the security agreement. In this regard, the Report will consider the borrower's continuing liability on the covenant notwithstanding such a transfer.

In chapter 10, various issues relating to possession of the secured property will be discussed, including whether a borrower should be entitled to retain possession after default for a stipulated period of time, the appropriate standard of care required of a lender in possession, the lender's claim to expenses, remuneration, and the costs of an agent, and the lender's possession of property leased by the borrower to another person. In the latter connection, we shall make recommendations with respect to residential and non-residential tenancies and with respect to binding and non-binding leases.

In chapter 11, the Commission will address various miscellaneous issues. For example, we shall examine whether the Rules of Civil Procedure,[7] or a new and separate procedure, should govern the resolution of disputes in the context of land security transactions. In addition, we shall deal with the award of costs in an application under the proposed new *Land Security Act* and offer proposals for reform in respect of the service of documents. The Commission will also consider the creation of a Land Security Committee, a permanent, specialized committee of experts in matters relating to land security, the mandate of which would be to monitor the law and practice in the area and to advise the Minister of Consumer and Commercial Relations on the need for reform.

RECOMMENDATION

The Commission makes the following recommendation:

> A new *Land Security Act* should be enacted. All substantive rules governing security interests in land should be included in that Act.

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[7] O. Reg. 560/84.

CHAPTER 2

THE CREATION, NATURE, AND ENFORCEABILITY OF SECURITY AGREEMENTS

1. TYPES OF SECURITY INTEREST IN LAND

As we indicated earlier,[1] the scope of the reform proposals in this Report is intended to encompass not only "mortgages", narrowly conceived, but all transactions that involve the use of land as security for a debt or obligation. In order to understand the ambit of our recommendations, it is necessary to describe the kinds of land security interest that can arise in Ontario. From this description, we shall see that the law in Ontario relating to land security transactions is both complex and diffuse, governed as it is by common law and equitable principles, as well as by several statutes, the main one of which, namely, the *Mortgages Act*,[2] may not be sufficiently comprehensive to include all means by which a security interest in land can be created.

In the immediately following description of how land security interests can arise, we shall defer any detailed consideration of section 6(1) of the *Land Registration Reform Act, 1984*,[3] which abolished the formality of the transfer of title to the lender. We shall also leave to a later section a discussion of the difference between a "mortgage" of land registered under the *Registry Act*,[4] which, until the enactment of the *Land Registration Reform Act, 1984*, involved a transfer of legal title to the lender, and a "charge" of land registered under the *Land Titles Act*,[5] which in law does not, and never did, involve such a transfer.

(a) LEGAL MORTGAGES

By far the most commonly utilized form of land security agreement in Ontario is the traditional purchase-money mortgage, by which a lender agrees to lend money to a borrower in return for a mortgage on the property to be purchased with that money. Almost all residential loans are secured by such mortgages.

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[1] See *supra*, ch. 1, sec. 3.

[2] R.S.O. 1980, c. 296.

[3] *Land Registration Reform Act, 1984*, S.O. 1984, c. 32. See discussion *infra*, this ch., sec. 2(b).

[4] R.S.O. 1980, c. 445.

[5] R.S.O. 1980, c. 230.

However, as the following examples illustrate, the terms of a mortgage agreement, as with any contract, can be as varied and individual as the parties themselves, particularly where the agreement is a commercial transaction. A mortgage of land may be only one part of a larger debenture agreement, by which a lender also takes an interest in the chattels, inventory, and profits of a business as security for a debt. Or a mortgage may be taken as additional, collateral security for an existing debt obligation and be payable only on demand by the lender. A mortgage may be used to secure a construction loan, with the loan amount paid by the lender to the borrower, in instalments, as various stages of the construction are completed. In each of these examples, as with the conventional residential purchase-money mortgage, the lender generally has no particular interest in the land itself, except as security. The lender's interest is in the satisfaction of the debt or obligation.

At common law, a legal mortgage is a transaction involving a transfer of the legal title to the property by the borrower to the lender, together with an agreement by the lender to lend, and by the borrower to repay, the amount secured. A mortgage provides that, upon performance of the mortgage obligations, the primary one of which is generally repayment of the debt, the lender will reconvey the legal title to the borrower. A mortgage also provides that if the borrower defaults in his or her performance of the mortgage obligations, the lender is entitled to retain absolute title to the property.

At common law, the conveyance of legal title, and the forfeiture of the borrower's right to reconveyance on default, represented more than merely the legal form of the agreement between the borrower and the lender; it also went to the heart of that agreement. Accordingly, if the borrower defaulted even once, the lender took the land absolutely. As a result, a lender would often obtain a windfall profit when a borrower fell into financial distress, since the value of the mortgaged property almost invariably exceeded the mortgage debt outstanding.

Equity, however, recognized that, in essence, the mortgage was simply security for a debt or obligation due; at equity, the borrower remained the owner of what is known as the beneficial interest, or equity of redemption, in the property.[6] Equity regarded the transfer of legal title as merely the form, and not the substance, of the transaction. Accordingly, it relieved against the forfeiture of that title and allowed the borrower to redeem the land upon performance of the mortgage obligations. This movement toward recognition that a mortgage was essentially security for an outstanding debt or obligation culminated in the enactment of the *Land Registration Reform Act, 1984*, which, as we have said, abolished the transfer of title aspect of the mortgage.[7]

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[6] See discussion of the development of mortgage remedies, *infra*, ch. 8, sec. 2.

[7] See *supra*, this ch., sec. 1.

(b) EQUITABLE MORTGAGES

Even aside from recent statutory provisions effecting changes in the legal nature of a mortgage, security interests in land did not, and do not, necessarily involve a transfer of legal title to the secured property.

Occasionally, a borrower and a lender will enter into an agreement that is intended to create a security interest in land, although for some reason the agreement is not in conventional form. In such a case, the lender acquires an interest that is recognized at equity, although he or she has not taken legal title as would be done under a legal mortgage (at least until the passage of the *Land Registration Reform Act, 1984)*. Such mortgages are called equitable mortgages. The term equitable mortgage means, generally, a mortgage that does not involve a transfer of legal title.[8] The most common type of equitable mortgage is a second mortgage, which generally takes the same form as a conventional first mortgage. However, it is the borrower's beneficial interest in the secured property, rather than his or her legal title, that is transferred to the lender.

Equitable mortgages can also be created in a variety of other ways. A conventional mortgage instrument that is intended to operate as a legal mortgage, but fails to operate in this fashion due to a defect in form, may, nevertheless, constitute an equitable mortgage.[9] An equitable mortgage can also be created by a written agreement, whereby the borrower agrees to execute a formal mortgage upon demand by the lender;[10] or it may be created by an informal agreement, such as a signed letter from a borrower to a lender that describes the secured property and evidences a present intention to give a mortgage.

As a general rule, equitable mortgages, like all agreements purporting to convey an interest in land, are unenforceable unless they meet the requirements of the *Statute of Frauds*[11] or fall within one of the exceptions to that Act.[12]

One type of equitable mortgage that does not have to meet the requirement of the *Statute of Frauds* is a mortgage by deposit of title deeds. The delivery of title deeds by an owner of land to a creditor or his or her agent, with the intent to grant security for the debt or obligation, creates an equitable mortgage.[13] The exception to the *Statute of Frauds* that arises where an equitable mortgage is created by the deposit of title deeds has been justified as an extension of the doctrine of part performance.[14] The doctrine itself has been much criticized.[15] However, it has long been considered too firmly established to be altered, except by legislation.[16]

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[8] See, generally, Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 80-95. But see s. 6 of the *Land Registration Reform Act, 1984*, *supra*, note 3.

[9] *Mestaer v. Gillespie* (1805), 11 Ves. Jun. 621, 32 E.R. 1230 (Ch.).

[10] Falconbridge, *supra*, note 8, at 83-84; *Rooker v. Hoofstetter* (1896), 26 S.C.R. 41, aff'g (1895), 22 O.A.R. 175; and *Bank of British Columbia v. Davis* (1983), 22 Alta. L.R. (2d) 258, [1983] 1 W.W.R. 185 (Q.B.).

[11] R.S.O. 1980, c. 481.

[12] See *infra*, this ch., sec. 4(d).

[13] See, generally, Fisher and Lightwood (ed. Tyler), *Law of Mortgages* (9th ed., 1977), at 44; Falconbridge, *supra*, note 8, at 85; *Russel v. Russel* (1783), 1 Bro. C.C. 269, 28 E.R. 1121; and *Zimmerman v. Sproat* (1912), 26 O.L.R. 448 (H.C. Div.).

The borrower's intent in depositing the title deeds can be established by parol evidence,[17] or even by an inference arising from the deposit itself, where the possession of the documents by the holder cannot otherwise be explained.[18] However, delivery of the deeds by mistake, or merely to facilitate the drafting of a legal mortgage, will not create an equitable mortgage. The deposit must be made with the intention of giving security.

It is not necessary that the person depositing the deeds be the holder of legal title to the property.[19] For example, the borrower may have given a legal first mortgage to a lender, who thereby took legal title; nevertheless, provided that the borrower has delivered to the second lender deeds that constitute material evidence of title, an equitable mortgage may be created. Indeed, it is possible to create several valid mortgages by the successive deposit of title deeds.[20]

The implementation of the land registry and land titles systems has not altered this method of creating a security interest in land. For example, a mortgage by deposit of title deeds is implicitly recognized by section 113 of the *Land Titles Act*,[21] which provides:

> 113. Subject to any registered estates, charges or rights, the deposit of a certificate of ownership or of an office copy of a registered lease for the purpose of creating a lien on the land to which the certificate or lease relates shall be deemed equivalent to a deposit of the title deeds of the land.

(c) LONG TERM AGREEMENTS FOR SALE

Another type of security interest in land can arise where a lender, who is the original owner of the land, sells the property to a purchaser, but retains legal title to the property until the purchase price is fully paid. Formal agreements, expressly providing that the vendor will retain legal title to secure payment of all instalment payments of principal and interest, are commonly used in Western Canada. Such agreements, generally referred to as long term agreements for sale, are used in parts of Ontario, although it is more common in vendor-financed sales to have a conveyance of title to the purchaser and a legal mortgage back to the vendor. Except with respect to the transfer of title, the standard form of such agreements is similar to a mortgage agreement, and generally contains standard clauses relating to insurance, repairs, and taxes, as well as terms establishing possessory rights[22] and a contractual power of sale.[23]

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[14] Spry, *The Principles of Equitable Remedies* (3d ed., 1984), at 270, and Megarry and Wade, *Law of Real Property* (5th ed., 1984), at 927-28.

[15] Maitland, *Equity* (2d ed., 1936), at 198-99.

[16] *Zimmerman v. Sproat*, *supra*, note 13, at 451.

[17] *Russel v. Russel*, *supra*, note 13, and *Kreick v. Wansbrough*, [1973] S.C.R. 588, 35 D.L.R. (3d) 275.

[18] *Re Wallis & Simmonds (Builders) Ltd.*, [1974] 1 W.L.R. 391, [1974] 1 All E.R. 561 (Ch.).

[19] *Zimmerman v. Sproat*, *supra*, note 13, and *Royal Bank of Canada v. Grobman* (1977), 18 O.R. (2d) 636, 83 D.L.R. (3d) 415 (H.C.J.).

[20] *Roberts v. Croft* (1857), 2 De G. & J. 1, 44 E.R. 887 (Ch.).

[21] *Supra*, note 5.

While the matter is not free from doubt, the rights and obligations of the parties to the type of security agreement described above are, at least arguably, analogous to those of a borrower and lender under a legal mortgage.[24] As with a mortgage, the terms of such agreements provide for forfeiture by the purchaser on default. However, again as in the case of a mortgage, equity recognized that the true nature of such agreements was mere security for the debt or obligation due. Accordingly, the strict common law rights of the vendor have been superseded by equitable rights given to the purchaser, analogous to the rights of a mortgagor. On default by the purchaser, the vendor must, in effect, obtain what is commonly called "foreclosure"[25] of the purchaser's "equity of redemption", or sell the property pursuant to a power of sale in the agreement. Technically, the vendor seeks an order for payment of the purchase price within a specified time and, upon default of payment by the purchaser, a declaration that the agreement is cancelled.[26]

(d) NON-CONSENSUAL LIENS

The security interests in land described thus far have all involved an intention on the part of the parties to create a security interest. However, certain security interests can arise by operation of law, and regardless of the intention, or consent, of the parties. The vendor's lien is one example of this type of security interest in land.[27]

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[22] See *infra*, ch. 10.

[23] See *infra*, ch. 8, esp. secs. 2(b) and 3(c).

[24] See, generally, Di Castri, *The Law of Vendor and Purchaser* (2d ed., 1976), at 662-83.

[25] Foreclosure is discussed *infra*, ch. 8, esp. secs. 2(a) and 3(a).

[26] Even though such cancellation of the agreement constitutes rescission of the contract, the purchase money paid to the vendor is not returned to the purchaser. The failure of the purchaser to obey the decree and pay the money found to be due is considered to be sufficient abandonment or repudiation of the contract by him to justify rescission without restitution. See *Standard Trust Co. v. Little (No. 2)* (1915), 24 D.L.R. 713, at 716, 8 W.W.R. 1112 (Sask. S.C.).

The vendor's lien constitutes an equitable interest in the land that comes into existence, by operation of law, upon execution of the agreement for sale of the property. It has been said that the vendor's lien constitutes a *quid pro quo* for the beneficial ownership that equity confers upon a purchaser the moment the agreement for sale is executed.[28] The lien secures any unpaid purchase money, and may be relied upon by a vendor where title has passed before the purchase money has been fully paid. The lien remains effective until it has been waived by the vendor,[29] but it may be defeated by the claim of a *bona fide* purchaser for value without notice.[30] The lien is enforced by application to the court for a declaration that the vendor is entitled to the lien, and an order that the property be sold in satisfaction of the lien.[31]

Other examples of non-consensual liens that create a security interest in land are statutory liens, such as those arising under the *Construction Lien Act, 1983*,[32] and the *Public Utilities Act*.[33] A mechanism for the enforcement of such liens is commonly established by the relevant statutes.

(e) JUDICIALLY RECOGNIZED SECURITY AGREEMENTS

Lenders occasionally have attempted to avoid the protections developed by equity in favour of borrowers, particularly the right of redemption, by representing a security arrangement to be some other form of arrangement. For example, an agreement between the parties may appear to be an outright sale of the property, with an option in favour of the vendor to repurchase the property on the fulfillment of certain conditions, such as payment of a specified sum. Whether such an arrangement is, in substance, an agreement to give a security interest in land is a question of fact, and depends on the intention of the parties when they entered into the agreement. The courts have been vigilant in considering all the circumstances in determining the true nature of the agreement.[34] Where, on such an inquiry, the court is satisfied that the transaction was intended to secure a loan or obligation, it has not hesitated to afford the borrower all the equitable rights and protections enjoyed by a mortgagor, including the right to redeem the property.

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[27] See, generally, Di Castri, *supra*, note 24, at 684-96. See, also, Burn (ed.), *Cheshire's Modern Law of Real Property* (12th ed., 1976), at 127.

[28] Di Castri, *supra*, note 24, at 685.

[29] *Ibid.*, at 689.

[30] *Ibid.*, at 692.

[31] *Ibid.*, at 693. The vendor may also obtain personal judgment for any deficiency arising from the sale of the property.

[32] S.O. 1983, c. 6, Part III.

[33] R.S.O. 1980, c. 423, s. 30(1), rep. and re-en. by S.O. 1982, c. 45, s. 1.

[34] *Fleming v. Watts*, [1944] S.C.R. 360, [1944] 4 D.L.R. 353.

2. THE STATUTORY FRAMEWORK GOVERNING SECURITY AGREEMENTS

(a) THE *MORTGAGES ACT*

The legal framework governing what may be called substantive mortgage law consists not only of an amalgam of common law and equitable principles, described briefly above, but also, in part, of statutory rights and obligations. We say that legislation governs "in part" because the main applicable statute, the *Mortgages Act*,[35] applies to "mortgages", defined in section 1(d) of the Act as including "any charge on any property for securing money or money's worth". The term "charge" is not defined, however, and it is unclear whether it would include all of the various kinds of security interest in land described above.

(b) THE *LAND REGISTRATION REFORM ACT, 1984*, AND THE ABOLITION OF A TRANSFER OF AN INTEREST IN LAND

As we have discussed, at common law a mortgage involves the transfer of the borrower's interest in the property to the lender. Equity, nevertheless, regards the borrower as the owner of what is known as the beneficial interest, or equity of redemption, in the property, and has developed various rights and protections for the borrower that are consistent with that view.

Prior to the enactment of the *Land Registration Reform Act, 1984*,[36] upon registration of a mortgage of land registered under the *Registry Act*,[37] legal title to the land was actually transferred to the lender. Accordingly, a mortgage contained words of conveyance. By contrast, under the land titles system in Ontario, governed by the *Land Titles Act*,[38] title is not, in law, transferred to the lender, whatever the form of the instrument; rather, a security agreement merely creates a "charge" against the land. Accordingly, there is no requirement of a conveyance of any estate to create an enforceable security interest. The charge is merely registered against the title and the borrower remains the registered legal owner.[39]

In 1984, Ontario enacted the *Land Registration Reform Act, 1984*.[40] The Act is designed to permit the establishment of an automated recording, retrieval and property mapping system for interests in land in Ontario. Among other things, the Act changes the land security forms hitherto used for land registered under the *Registry Act* and the *Land Titles Act*.

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[35] *Supra*, note 2, s. 1(d).

[36] *Supra*, note 3.

[37] *Supra*, note 4.

[38] *Supra*, note 5.

[39] Nevertheless, just as in the case of *Registry Act* mortgages, charges under the land titles system still almost invariably contain words of transfer of the borrower's interest in the property, even though, as we have said, such words are ineffectual for that purpose: see *Land Registration Reform Act, 1984*, *supra*, note 3, s. 6(1), discussed *infra*, this sec.

[40] *Supra*, note 3.

Part I of the Act, which deals with conveyancing documents and procedures, "applies to documents affecting or relating to land in the parts of Ontario that are designated by regulation".[41] All of Ontario has now been so designated.[42]

The *Land Registration Reform Act, 1984* provides that a mortgage is merely one form of "charge" on property. Section 1(a) of the Act defines a "charge" as "a charge on land given for the purpose of securing the payment of a debt or the performance of an obligation, and includes a charge under the *Land Titles Act* and a mortgage, but does not include a rent charge".

With respect to the legal nature of a mortgage, reference should be made to section 6(1) of the *Land Registration Reform Act, 1984*. This provision amends the law, at least in respect of mortgages of *Registry Act* land, by providing that a "charge does not operate as a transfer of the legal estate in the land to the chargee". However, this change is not intended to affect the substantive rights of the borrower or lender. Section 6(3) specifically provides that "a chargor and chargee are entitled to all the legal and equitable rights and remedies that would be available to them if the chargor had transferred the land to the chargee by way of mortgage, subject to a proviso for redemption".

3. THE LAW IN THE UNITED STATES

As a general proposition, it may be said that the law in the United States respecting the creation of security interests in land is not dissimilar in principle to that in Ontario, although the greater number of jurisdictions in the United States adds somewhat to the complexity of the law in that country. Partly as a result of different substantive rules governing mortgages, and partly because existing legislation does not always apply to all types of security agreement, an attempt was made by the National Conference of Commissioners on Uniform State Laws to create a new, uniform statute that was more comprehensive in scope.

Section 3-102 of that statute, the Uniform Land Transactions Act,[43] provides that, subject to certain exclusions,[44] Article III, relating to secured transactions, applies to any transaction, regardless of its form, intended to create a security interest in real estate. These transactions include a mortgage, deed of trust, trust deed, security deed, contract for deed, land sales contract, lease intended as security, assignment of leases or rents intended as security for an obligation, and any other consensual lien or title retention contract intended as security for an obligation.

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[41] *Ibid.*, s. 2.

[42] O. Reg. 35/85, s. 1(1).

[43] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

Throughout this Report, reference will be made to the Uniform Land Transactions Act, generally to the exclusion of the law in the individual states. The latter is often confusing and unwieldy, while the former is an instructive model of legislation designed to rationalize the existing law of mortgages in the United States.

The Comment to section 3-102 points out that transactions in the form of absolute deeds of conveyance or of leases are subject to Article III, if the understanding of the parties or the effect of the arrangement shows an intention to create a security interest. The Comment emphasizes that the list of traditional security devices given is merely illustrative and is not exhaustive; other devices, old or new, are encompassed by Article III, so long as the requisite intent to create a security interest is found.

Under section 3-104, if the security interest is created by operation of law, and not by a manifested intent, it is excluded from the provisions. For example, the security interest given to an unpaid supplier of materials or subcontractor in respect of land on which the supplier or subcontractor made an improvement is governed by statutes on mechanics' liens. These liens are statutory and do not arise by reason of the consent of the owner of the land.

Section 3-203(a) of the Uniform Land Transactions Act establishes three requirements that must be satisfied before a security interest "attaches", that is, before a security interest can come into existence. The Act requires that there be a signed security agreement containing a description of the collateral, that value have been given, and that the debtor have an interest in the collateral. The Comment explains that the requirement of writing is in the nature of a statute of frauds, so that a secured creditor may not enforce the security agreement without written evidence. Neither section 3-203, nor the Comment to it, discuss such issues as what constitutes sufficiency of writing or the possible exceptions to the statutory requirements.

4. PROPOSALS FOR REFORM

(a) The Scope of New Legislation

As we have discussed, security interests in land can arise in a variety of ways. Most often, a security interest arises by an express agreement that evidences the parties' intention and sets out the nature of the transaction and their respective rights and remedies. However, security interests can also arise by operation of law, as with the vendor's lien, or may be recognized by the court where the requisite intention is found, although the agreement does not appear to be a secured transaction. We believe that the rights and remedies proposed in this Report, particularly the protections created in favour of borrowers, should apply with respect to any agreement that is intended to create a security interest in land; these rights and remedies should not be avoided by using a form of transaction that superficially appears to be other than a security agreement.

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[44] Excluded transactions are set out in § 3-104 of the Act, which lists various non-consensual security interests, such as a landlord's or vendor's lien, as well as mechanics' liens and judgments.

For example, a commercial builder may wish to avoid the proposed new disclosure requirements,[45] or the borrower's rights upon default,[46] when he or she sells the property to a purchaser and also agrees to finance the purchase. Such a builder may characterize what is, in fact, a security agreement as an outright sale to the borrower, even though the builder intends to rely on the vendor's lien[47] as security in the event of default by the borrower. We believe that, the intent being to create a security interest, such an arrangement should be comprehended by our proposed new legislation so that the purchaser-borrower will have the benefit of the Act. Other examples may be found to illustrate the principle espoused above.

Accordingly, we recommend that the new *Land Security Act* proposed by the Commission[48] should provide that the Act applies to every transaction, regardless of its form, that is intended to create a security interest in land, including a security agreement, mortgage, charge, debenture, trust deed, and any transaction in which an interest in or title to the land is retained by the transferor after the transferee has taken possession of the land, but should not apply to non-consensual liens and similar interests in land, such as vendors' liens and construction liens.[49] Since the creation of a security interest simply by means of a deposit of title deeds would undermine the Commission's goal of providing adequate disclosure of information to borrowers,[50] we recommend that it should no longer be possible to create a security interest in land by this means.[51]

It should be a question of fact in every case whether the parties intended to create a security interest in land. The majority of agreements will evidence an intention to create a security interest simply by being referred to as a mortgage or a charge. Some agreements, although not expressly described as a security agreement, will nevertheless clearly indicate the intention to create a security interest by their terms. For example, an agreement that provides that title will be retained by the vendor after the purchaser goes into possession, and will be transferred to the purchaser only upon payment of a series of instalments of principal and interest, indicates an intention to create a security interest.

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[45] See *infra*, ch. 7.

[46] See *infra*, ch. 8.

[47] See *supra*, this ch., sec. 1(d).

[48] See *infra*, Appendix 1 (hereinafter referred to as "draft Act").

[49] Draft Act, s. 2.3. See, also, s. 1.1.18 ("security agreement") and s. 1.1.19 ("security interest"). By analogy, in the context of personal property security interests, see *Personal Property Security Act*, R.S.O. 1980, c. 375, s. 2(a).

[50] See *infra*, this ch., sec. 4(d), and *infra*, ch. 7.

[51] It bears mentioning here that, under recommendations to be made *infra*, this ch., sec. 4(d), a security interest would not be enforceable unless the borrower has signed a security agreement that contains an adequate description of the land, acknowledges the lender's security interest, and is in registrable form.

(b) THE EFFECT OF THE ABOLITION OF A TRANSFER OF TITLE

From the first intervention of equity on behalf of borrowers, the fundamental principles of mortgage law have developed firmly on the basis that the true nature of the mortgage relationship between the borrower and the lender is a commercial one, namely, that of debtor and creditor. The lender's interest in the land is merely as security for the debt.

The view that a security interest in land should reflect the essential debtor-creditor nature of the agreement and the legitimate expectations of the parties manifests itself in respect of charges registered against *Land Titles Act* land, and, more recently and dramatically, in respect of "charges", including mortgages, under the *Land Registration Reform Act, 1984*. As a result, a security agreement, whether registered under the *Land Titles Act* or under the *Registry Act*, no longer involves a transfer of any estate or interest in land, notwithstanding any term in the agreement to the contrary. Rather, any agreement, regardless of its form, that in substance creates a security interest in land, simply gives rise to a charge on the land. We firmly believe that this recent development rests on a sound theoretical and practical foundation.

We noted earlier that section 6(3) of the *Land Registration Reform Act, 1984* basically provides that the borrower and lender are entitled to all the legal and equitable rights and remedies that would be available to them if the borrower had transferred the land to the lender by way of a mortgage. The Commission's proposed *Land Security Act* is designed to be a complete code that would, among other things, abolish many of the legal and equitable incidents of a "mortgage". Because section 6(3) may well serve to reintroduce into the law some of the existing rules that we believe ought to be abolished, we recommend that the equivalent of section 6(3) should not be included in our proposed Act.[52]

(c) TERMINOLOGY

Earlier in this chapter, we recommended that the provisions of the Commission's proposed legislation should govern all agreements that are intended to create a security interest in land. In the immediately preceding section, we also noted that, as a result of section 6(1) of the *Land Registration Reform Act, 1984*[53] a security agreement no longer involves a conveyance of an estate in land, but simply creates a charge as security for a debt or obligation. In the Commission's view, this change in the legal nature of the type of security instrument known as a mortgage, and the broadened scope of the concept of a security agreement, call for a new legal term that will leave behind the historical baggage inextricably linked to the concept of a "mortgage".

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[52] We envisage that the provisions in the *Land Registration Reform Act, 1984*, *supra*, note 3, relating to security agreements would be transferred, sometimes in an amended form, to the draft *Land Security Act* proposed by the Commission.

[53] *Supra*, note 3.

The Legislature has already expressed a like intent in the provisions of the *Land Registration Reform Act, 1984*, which provides for a broad definition of a "charge" to include any charge on land given for the purpose of securing the payment of a debt or the performance of an obligation. A mortgage is but one kind of charge under that Act.

Accordingly, we recommend that the proposed *Land Security Act* should adopt new terminology that more truly reflects the nature of an agreement that is intended to create a security interest in land. In order to avoid confusion with a "charge" registrable under the *Land Titles Act*, we have rejected the use of that term. We recognize that the term "charge" is also used under the *Land Registration Reform Act, 1984*, but in the context of registration provisions. For the sake of simplicity and in order to highlight the substance of the instrument, and, as well, because it is comprehensible to lawyers and laypersons alike, we recommend that the term "security agreement" should be used to encompass any writing that creates or provides for a security interest in land, and should include a charge under the *Land Titles Act* and a mortgage and any collateral agreement relating to the security interest other than mortgage insurance, but should not include a rent charge.[54]

(d) THE ENFORCEABILITY OF A SECURITY AGREEMENT

The vast majority of security interests are created by means of a formal written security agreement that specifies the respective rights and remedies of the parties. While, at present, it is possible to create a security interest in land without a written agreement, such an interest is generally unenforceable unless it meets the requirements of the *Statute of Frauds*.[55] The *Statute of Frauds* makes an agreement to give an interest in land unenforceable unless it is evidenced by a written memorandum that identifies the land and is signed by the person giving the interest. These statutory requirements are not onerous, particularly since the courts have adopted a liberal approach to determine what constitutes a sufficient memorandum.[56] Furthermore, two general exceptions to these requirements have been developed by equity. Equity will enforce what would otherwise be an insufficient agreement where a defendant has attempted to rely dishonestly on the absence of a sufficient writing, and where there has been part performance of the obligation.[57]

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[54] Draft Act, s. 1.1.18.

[55] *Supra*, note 11, s. 4.

[56] See Law Reform Commission of British Columbia, *Report on the Statute of Frauds* (1977), at 43-44, and Alberta, Institute of Law Research and Reform, Background Paper No. 12, *Statute of Frauds* (1977), at 22-24. See, also, generally, Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (1987), ch. 5, "Contractual Aspects of the *Statute of Frauds*", esp. secs. 3(a)(iii) and 6(c); Alberta, Institute of Law Research and Reform, Report No. 44, *The Statute of Frauds and Related Legislation* (1985); and Manitoba Law Reform Commission, Report No. 41, *Report on the Statute of Frauds* (1980).

One of the central aims of the Commission's reform proposals in this Report is to ensure that a borrower has a written and comprehensible form of security agreement. To this end, the Commission will recommend in a later chapter that there should be a scheme for the disclosure of information, in plain language, to certain borrowers at various stages of the loan process.[58] It is clear that an unwritten or informal mechanism for the creation of an enforceable security interest could undermine this goal of disclosure. We are particularly concerned with the existing method of creating a security interest merely by a deposit of title deeds, since a borrower may have no written record of the agreement, let alone a written, comprehensible, and informative security agreement. Accordingly, we have recommended that it should no longer be possible to create a security interest in land by this means.[59]

The Commission believes that it is important that an enforceable security agreement meet certain minimum requirements and formalities. Accordingly, we recommend that a security interest should not be enforceable by or against a borrower unless the borrower has signed a security agreement that contains an adequate description of the land, acknowledges the lender's security interest, and is registrable under the *Land Registration Reform Act, 1984*.[60]

In some instances, however, whether due to mistake, inadvertence, or lack of familiarity with the requisite formalities, the parties may not, in fact, have brought into existence an enforceable security agreement. For example, a security agreement may be unenforceable either because the borrower did not sign it, or because there is no proper description of the secured land, or because there is no adequate acknowledgment of the lender's security interest. Alternatively, the agreement may not be in registrable form.

We wish to avoid the possibility that the intention of the parties might be defeated simply due to technical defects. We share the traditional reluctance of the courts, illustrated by the highly developed case law under the *Statute of Frauds*, to allow one party to rely on a lack of conformity with technical formalities to thwart the legitimate expectations of the other party. We believe that, so long as certain minimum conditions have been met, relief should be available.

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[57] See, generally, Spry, *supra*, note 14, at 242-84.

[58] See *infra*, ch. 7.

[59] See *supra*, this ch., sec. 4(a).

[60] *Supra*, note 3. See draft Act, s. 3.2(1). See *infra*, ch. 7, sec. 2(a)(i), for a discussion of the form of a registrable charge under the *Land Registration Reform Act, 1984*.

This Commission, in its *Report on Amendment of the Law of Contract*, *supra*, note 56, ch. 5, recommended that the existing writing requirements in s. 4 of the *Statute of Frauds* relating to the sale of land or any interest in land should be repealed, subject to a requirement that such contracts not be enforceable on the evidence of the party alleging the contract in the absence of corroboration by some other material evidence: *ibid.*, sec. 6(c). This recommendation would not apply to the creation of a security agreement, which, at present and under our proposals, does not involve the transfer of an interest in land.

Accordingly, we recommend that, where the borrower has signed a security agreement that describes the secured land and acknowledges the lender's interest, but fails to meet the registration requirements of the *Land Registration Reform Act, 1984*, the court, on the application of the lender, should compel the borrower to sign a security agreement in registrable form.[61] Under these circumstances, the court should not have the discretion to refuse the granting of relief to the lender: what is involved here is merely technical registration requirements, which do not lie at the very heart of the legal relationship created between the parties.

We further recommend that, where a security agreement is unenforceable because it does not satisfy one or more of the recommended requirements other than that it be registrable under the *Land Registration Reform Act, 1984*, and where it appears to the court to be just, the court, on the application of the lender, should have the power to compel the borrower to sign a security agreement in registrable form.[62]

RECOMMENDATIONS

The Commission makes the following recommendations:

1. (1) Subject to paragraph (2), the *Land Security Act* should apply to every transaction, regardless of its form, that is intended to create a security interest in land, including a security agreement, mortgage, charge, debenture, trust deed, and any transaction in which an interest in or title to the land is retained by the transferor after the transferee has taken possession of the land, but should not apply to non-consensual liens and similar interests in land, such as vendor's liens and construction liens.

   (2) It should no longer be possible to create a security interest in land by means of a deposit of title deeds.

2. The *Land Security Act* should constitute a complete code. In order to avoid reintroducing into the law certain legal and equitable rules that should be abolished, the Act should not include a provision akin to section 6(3) of the *Land Registration Reform Act, 1984*.

3. In the context of land security transactions, the term "security agreement", rather than "mortgage", should be used. The term should encompass a writing that creates or provides for a security interest in land, and should include a charge under the *Land Titles Act* and a

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[61] Draft Act, s. 3.2(2).

[62] *Ibid.*, s. 3.2(3).

mortgage and any collateral agreement relating to the security interest other than mortgage insurance, but should not include a rent charge.

4. (1) A security interest should not be enforceable by or against a borrower unless the borrower has signed a security agreement that contains an adequate description of the land, acknowledges the lender's security interest, and is in registrable form.

(2) Where the security agreement is not in registrable form, but otherwise satisfies the requirements of paragraph (1), the court, on the application of the lender, should compel the borrower to do what is necessary to put the security agreement in registrable form.

(3) Where the security agreement is unenforceable by reason of any defect other than that it is not in registrable form and where it appears to the court to be just, the court, on the application of the lender, should have the power to compel the borrower to sign a security agreement in registrable form.

CHAPTER 3

THE ABOLITION OF ANOMALIES AND ANACHRONISMS

1. CONSOLIDATION

(a) PRESENT LAW

The equitable doctrine of consolidation is founded on the maxim that "he who seeks equity must do equity". In its simplest form, the doctrine requires that a borrower who gives more than one mortgage to the same lender, and is in default under each of the mortgages, must be prepared to redeem both mortgages. The borrower is not entitled to redeem only one unless the lender agrees that he or she may do so.[1]

(b) PROPOSALS FOR REFORM

We are of the view that a borrower who is in difficult financial straits should have every opportunity to put his or her affairs in order and, as far as possible, rectify the default. The doctrine of consolidation is inconsistent with this view. If, for example, a lender holds two security agreements, one with respect to a borrower's primary residence and another with respect to his or her cottage, and both agreements are in default, the lender could refuse to allow the borrower to rectify the default and redeem the residence unless he or she also redeems the cottage. Since such a borrower might be able to refinance only one of the properties, but not both, the effect of the doctrine of consolidation could be that the borrower would lose everything. We believe that the doctrine is inappropriate, and, accordingly, we recommended that the doctrine of consolidation be abolished.[2]

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[1] See, generally, Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 185-94.

[2] See the draft *Land Security Act* proposed by the Commission, *infra*, Appendix 1 (hereinafter referred to as "draft Act"), s. 6.33.

2. TACKING

(a) PRESENT LAW

The doctrine of tacking developed to govern priorities between competing mortgages on the same property,[3] and was founded on the notion that priority *prima facie* accompanied the legal estate. As we shall discuss below,[4] priorities in respect of registered security agreements are governed by the relevant land registration statute, either the *Registry Act*[5] or the *Land Titles Act*.[6] Prior to the existence of land registration systems, the doctrine of tacking applied where a lender took a third mortgage without notice of a second mortgage. If the third lender acquired the legal estate by purchasing the first mortgage, without notice of the second mortgage, he was entitled to "tack" the amount due under the third mortgage onto the first mortgage, thereby obtaining priority over the second mortgage for the combined amount.

Section 67 of the *Registry Act* expressly provides that tacking is not allowed to prevail against the provisions of the Act. Under the *Land Titles Act*, a lender does not take legal title and, therefore, tacking does not arise.

(b) PROPOSALS FOR REFORM

In chapter 2 we noted that, as a result of section 6(1) of the *Land Registration Reform Act, 1984*,[7] a security interest in land no longer involves a transfer of legal title to the secured property; rather, regardless of form, a security agreement constitutes merely a charge on the property.[8] We believe that, since the doctrine of tacking is based on the notion that priority follows the legal estate, it is no longer appropriate or applicable to the issue of priorities among security interests. For the sake of clarity, we therefore recommend that the doctrine of tacking should be abolished.[9]

3. CLOGS ON THE EQUITY OF REDEMPTION

(a) PRESENT LAW

As we have discussed,[10] while the common law held the borrower to the strict terms of the mortgage contract, equity intervened and created protections for the borrower that were consistent with the true nature of the borrower's relationship with the lender. Not surprisingly, lenders made various attempts to avoid the rights that equity created for the borrower and the obligations that equity imposed on the lender.

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[3] See, generally, Falconbridge, *supra*, note 1, at 195-96.

[4] See *infra*, ch. 5, sec. 1.

[5] R.S.O. 1980, c. 445.

[6] R.S.O. 1980, c. 230.

[7] S.O. 1984, c. 32.

[8] See *supra*, ch. 2, sec. 2(b).

[9] Draft Act, s. 3.12(8).

[10] See *supra*, ch. 2, sec. 1(a). See, also, *infra*, ch. 8, sec. 2.

Equity responded by developing a number of principles that prohibited the lender from converting a security agreement into any other kind of transaction to which the protections of equity would not apply. These principles have come to be considered as various aspects of a more general prohibition against "clogs on the equity of redemption". They are expressed in the form of various maxims that are invoked, often interchangeably, where a lender includes in the security agreement any stipulation for his or her benefit, other than the usual payment of principal and interest. The case law that has developed around these principles and maxims has sometimes been confusing and, occasionally, irreconcilable.

The first maxim is "once a mortgage, always a mortgage". In the House of Lords case of *Noakes & Co., Ltd. v. Rice*,[11] Lord Davey explained that this maxim is simply another way of saying that a mortgage cannot be made irredeemable; that is, if property is transferred to a lender to secure a loan, it is considered a mortgage, regardless of its form. Any attempt to convert that security arrangement into an absolute transfer on the borrower's default would be ineffective and the borrower would be given the opportunity to redeem the mortgage and recover the land. Consequently, for example, an option given to the lender to purchase the property upon default by the borrower would be ineffective to limit the borrower's right to redeem the property.[12]

The second maxim is that "the lender shall have no collateral advantage". This maxim reflects the view, held by equity, that a lender's entitlement is solely to his or her security in the property, and not to any benefit or advantage that flows from the security itself, such as profits from a business operating on the premises. The genesis of this principle was discussed by Lord Haldane in *G. and C. Kreglinger v. New Patagonia Meat and Cold Storage Co. Ltd.*,[13] the leading House of Lords case on the issue of collateral advantage. He explained that the prohibition against lenders obtaining a collateral advantage was equity's extension of the public policy of the time that placed restrictions on the rate of interest that could be exacted by a lender. Equity, influenced by that public policy, developed the prohibition against collateral advantage in order to prevent a lender from demanding a usurious benefit by other means. Lord Haldane pointed out that this public policy had changed and that the usury laws had long since been repealed. Accordingly, he was of the view that a collateral advantage could be stipulated for by the lender, provided that the lender had not acted unfairly or oppressively, and provided that the collateral advantage did not conflict with the rule that permitted the borrower to exercise any contractual or equitable right of redemption.

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[11] [1902] A.C. 24 (H.L.), at 32.

[12] *Vernon v. Bethell* (1762), 2 Eden 110, at 113, 28 E.R. 838; *Fallon v. Keenan* (1866), 12 Gr. 388; *Arnold v. National Trust Co., Ltd.* (1912), 3 W.W.R. 183, 7 D.L.R. 754 (Alta. S.C.); and *Lewis v. Frank Love, Ltd.*, [1961] 1 W.L.R. 261, [1961] 1 All E.R. 446 (Ch.).

[13] [1914] A.C. 25, at 37, [1911-13] All E.R. 970 (H.L.) (subsequent reference is to [1914] A.C.). *G. and C. Kreglinger* was adopted by the Supreme Court of Canada in *London Loan & Savings Co. v. Meagher*, [1930] S.C.R. 378, [1930] 2 D.L.R. 849.

In *G. and C. Kreglinger*,[14] Lord Parker shared Lord Haldane's view that equity no longer prohibited, on principle, a collateral advantage. He observed that, since the repeal of the usury laws, every case in which a stipulation for a collateral advantage had been open to objection had involved either an unconscionable term in the agreement, a penal clause clogging the equity of redemption, or a condition that was repugnant to any contractual or equitable right of redemption.

The third maxim is that "there must be no stipulation in the mortgage that will fetter the property on redemption". This prohibition is similar to the prohibition against a lender obtaining a collateral advantage, except that it appears to contemplate a condition or advantage that will outlast the redemption of the security. For example, a condition that the borrower will sell only the lender's brand of beer on the secured property for ten years after the mortgage has been paid may be considered a "fetter" on the equity of redemption and, therefore, invalid.[15]

It is not entirely clear whether the decision in *G. and C. Kreglinger*[16] has abolished this prohibition. One commentator has suggested that the distinction between a valid collateral advantage and an invalid fetter depends on whether the advantage was intended by the parties to be a term of the mortgage, or whether it was the subject of an independent bargain that was incidentally connected to the security agreement as part of a larger transaction. If the advantage was a term of the security agreement that was intended to endure beyond redemption, it would be invalid; if it was the subject of an independent bargain, it would be valid.[17]

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

The past decade has witnessed dramatic innovations and changes in methods of financing, as a result of both substantial fluctuations in interest rates and differently structured financial markets. These changes have resulted in a far broader range of loan and security agreements, many of which tie a lender's return on the money loaned to increases in the value of the secured property or to the profits earned on that property. The lender is often, in effect, sharing some of the risk in return for sharing some of the benefits. Such agreements are subject to negotiation between the parties who, it is presumed, are equally capable of protecting their own interests in the negotiations. Nevertheless, lenders are still uneasy that, notwithstanding the significant erosion of the doctrine of clogs on the equity of redemption as a result of the *G. and C.*

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[14] *Supra*, note 13, at 56.

[15] See the *dictum* of Lord Davey in *Noakes & Co., Ltd. v. Rice*, *supra*, note 11, at 35.

[16] *Supra*, note 13.

[17] Falconbridge, *supra*, note 1, at 57.

Kreglinger decision, the doctrine might be resurrected and applied in aid of a borrower who, although satisfied with the arrangement at the time of the negotiations and agreement, seeks relief at a time of financial distress.

Following *G. and C. Kreglinger*, there appears to be little left of the prohibition against obtaining a collateral advantage, except in cases where the lender's conduct has been harsh or unconscionable. Indeed, an express, wholesale abolition of the doctrine of clogs on the equity of redemption would result in little real change in the law, except that it would free lenders from the need to ensure that such terms are regarded as an independent bargain, only incidentally connected to the security agreement, and not a "fetter" that is part of the security agreement and that will outlast its term.

It is arguable, therefore, that the concerns that remain to be addressed by the doctrine relate essentially to inequality of bargaining power, or unconscionability. But these are, in turn, subject to more general and flexible relief, either under the doctrine of unconscionability[18] or on the basis of public policy, such as in the case of prohibitions against restraint of trade.[19]

There remains, nevertheless, some concern regarding the less financially sophisticated borrower, and particularly with the possibility that a complete abolition of the doctrine of clogs on the equity of redemption might allow a lender to negotiate an option to purchase the property immediately upon the borrower's default, thereby circumventing the borrower's right to redeem the property.

(c) PROPOSALS FOR REFORM

The original impetus for the rule prohibiting clogs on the equity of redemption was to ensure that the true nature of the transaction was preserved, that is, that an agreement to give security for a loan was not transformed, at the lender's option, into an outright alienation of the borrower's interest in the property. It is another example of equity's concern with overreaching by a powerful lender.

We recognize that this concern is still legitimate with respect to what we have called protected borrowers, that is, predominantly, residential borrowers.[20] The invariable expectation of such borrowers is that, when granted, a security agreement is, and will remain, only a loan agreement. We believe that the special protections that we shall recommend for protected borrowers should not be avoided by the simple mechanism of giving the lender an option to alter the essence of the transaction from a loan to a sale, where, for example, there has been a default by the borrower.

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[18] See Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (1987), ch. 6, "Unconscionability". See, also, *Lloyds Bank Ltd. v. Bundy*, [1975] Q.B. 326, [1974] 3 All E.R. 757 (C.A.); Waddams, *The Law of Contracts* (2d ed., 1984), at 326-407; and *Unconscionable Transactions Relief Act*, R.S.O. 1980, c. 514.

[19] Waddams, *supra*, note 18, at 416-19.

[20] See, by way of brief summary, *supra*, ch. 1, sec. 3, and, in more detail, *infra*, ch. 4.

However, in our view, the same argument generally does not apply with respect to commercial transactions. We believe that there is no compelling reason why most commercial parties should not be free to negotiate flexible and innovative methods of financing, tailored to their individual requirements. The current use of price level adjustment agreements[21] and shared appreciation agreements[22] indicates an increasing tendency for lenders to share both the risks and the profits of a commercial venture. We believe that, provided there is nothing in such arrangements that is harsh or unconscionable, or otherwise against public policy, the legitimate expectations of both the borrower and the lender should be enforceable.

We are of the view that, after *G. and C. Kreglinger*, any remaining objections based on the rule against clogs on the equity of redemption would generally be addressed more adequately in the context of the law relating to unconscionability.[23] With respect to stipulations that involve a collateral advantage or "fetters", the concerns might be better addressed in the context of the law respecting restraint of trade. In our view, an aggrieved borrower could seek relief through these more general remedies, the common concern of which is, in effect, inequality of bargaining power.

Accordingly, we recommend that, subject to an exception in respect of protected borrowers, discussed below, no term contained in a land security agreement should be unenforceable by reason only that it is a clog on the equity of redemption.[24] For greater certainty, we recommend that the proposed *Land Security Act* should specifically provide that no term of any security agreement shall be unenforceable by reason only that (1) the lender has a right to share in any profits earned by the borrower from any enterprise or transaction financed by the loan, or (2) the amount to be repaid as principal when the security agreement is due, or otherwise on redemption, includes part of any increase in the value of the land, or is increased in proportion to any changes in any index or other measure reflecting the rate of inflation, between the date of the agreement and the date of repayment of the amount due or the date of redemption.[25]

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[21] Under a price level adjustment agreement, the lender has a right to share in any profits earned from any enterprise or transaction financed by the loan.

[22] Under a shared appreciation agreement, the amount to be repaid as principal when the security agreement is due includes part of any increase in the value of the land, or is increased in proportion to any changes in any index or other measure reflecting the rate of inflation between the date of the agreement and the date of repayment of the amount due.

[23] See draft Act, s. 7.5, which preserves the law of unconscionability in the context of secured transactions.

The Commission, in its *Report on Amendment of the Law of Contract*, *supra*, note 18, ch. 6, has recommended that the doctrine of unconscionability be given express statutory recognition. Under the Commission's proposals, the court would have power to grant relief from contracts and contractual terms that are unconscionable, as determined in accordance with decisional criteria proposed by the Commission: *ibid.*, secs. 3 and 4.

[24] Draft Act, s. 3.5(1).

We further recommend that, subject to the exceptions discussed below, where the security agreement involves a protected borrower, no provision that purports to give the lender a right to purchase the property on or before redemption, or on default, should be enforceable.[26] Legislation implementing this proposal should not apply, however, where, at the time the security agreement is signed, two conditions are satisfied: (1) the borrower is either employed, or is intending to become employed, by the lender or a person affiliated with the lender; and (2) the terms of the agreement that entitles the lender to purchase the secured property are fair and reasonable, having regard to the circumstances of the employment or intended employment.[27]

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The doctrine of consolidation should be abolished.

2. The doctrine of tacking should be abolished.

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[25] *Ibid.*, s. 3.5(2).

In 1984, a draft *Real Property Security Act* was prepared, for discussion purposes only, for the Alberta Institute of Law Research and Reform. While the draft legislation does not bear the official *imprimatur* of the Institute, it is instructive to describe one of its provisions here.

The Act provides for the abolition of the doctrine of clogs on the equity of redemption. Section 1.2(1) of that Act provides as follows:

> 1.2.-(1) Except as provided in this Act, in the Unconscionable Transactions Act, U-2, and in the Land Titles Act, L-5 [and in other generally applicable law,] a security agreement is effective according to its terms between the parties and also against purchasers and creditors notwithstanding rules denominated by the terms 'fettering', 'clogging the equity of redemption', 'claiming a collateral advantage' and rules of similar import.

The Comment to the draft Act explains that the general scheme of the Act is to permit the parties to make their own bargains, while providing, in specific instances, rights and remedies applicable in the absence of, and in certain circumstances despite, specific agreement. The Comment points out that, in order to "clear the air" for the application of this principle, it was necessary to clarify that rules previously clustered around the notions of "fettering" or "clogging" are no longer to be applied as rules of thumb and in a mechanical way; it is this purpose that the language following the "notwithstanding" clause in subsection (1) is intended to accomplish. The Comment points out that the "bracketed language is to make applicable the provisions of this act *under* both generally applicable law and the specifically mentioned acts" (emphasis in original).

[26] Draft Act, s. 3.5(3).

[27] *Ibid.*, s. 3.5(4).

3. (1) Subject to paragraph (3), no term contained in a security agreement should be unenforceable by reason only that it is a clog on the equity of redemption.

(2) For greater certainty, the proposed *Land Security Act* should provide specifically that no term of any security agreement should be unenforceable by reason only that:

(a) the lender has a right to share in any profits earned by the borrower from any enterprise or transaction financed by the loan; or

(b) the amount to be repaid as principal when the security agreement is due, or otherwise on redemption, includes part of any increase in the value of the land, or is increased in proportion to any changes in any index or other measure reflecting the rate of inflation, between the date of the agreement and the date of repayment of the amount due or the date of redemption.

(3) Subject to paragraph (4), where the security agreement involves a protected borrower (see chapter 4), no provision that purports to give the lender a right to purchase the property on or before redemption, or on default, should be enforceable.

(4) Legislation implementing the recommendation in paragraph (3) should not apply where, at the time the security agreement is signed:

(a) the borrower is either employed, or is intending to become employed, by the lender or a person affiliated with the lender; and

(b) the terms of the agreement that entitles the lender to purchase the secured property are fair and reasonable, having regard to the circumstances of the employment or intended employment.

CHAPTER 4

THE PROTECTED BORROWER

1. INTRODUCTION

As discussed in chapter 2 of this Report, the Commission has taken the position throughout this Project that a security agreement is, in essence, a contract. As with any contract, it has been assumed that, for the most part, the terms of the security agreement have been freely negotiated and executed by the parties. The Commission has therefore adopted a general principle of non-interference with secured transactions.

While secured transactions may fairly be regarded as simply one of many forms of business dealing, the Commission recognizes that not all parties and, particularly, not all borrowers, are alike. Put simply, some are more financially and commercially sophisticated than others. Consequently, we have given consideration to the question whether an exception to the general principle of non-interference should be made in order to grant special protection to a particular class of persons.

2. TRENDS IN "CONSUMER PROTECTION" LAW

The existing law of mortgages is of general application, applying to all transactions regardless of the nature of either the borrower, the lender, or the property. There are no special protections or exceptions created for any particular class of borrower, lender, or property.

There exists, however, a developing trend in other areas of the law towards the creation of special statutory protections for certain classes of persons, based on a recognition that an inequality in bargaining power can exist between an established commercial institution and a less sophisticated or uninformed individual. This trend, coming under the general rubric of "consumer protection", has witnessed the creation of such protections in a variety of ways.

For example, legislation may regulate the conduct of commercial parties by means of some form of registration or licensing requirement. Through the necessity of registration or obtaining a licence, the Province purports to set qualifying standards for prospective participants in a particular activity and, to some degree, to monitor their conduct after they have met the requisite requirements. In many cases, legislation will specify minimum standards of conduct for commercial parties and may also create a mechanism by which a consumer's grievances may be formally aired and resolved where these standards are breached.

A somewhat less direct form of intervention in commercial transactions is legislation that requires a commercial party to provide certain critical information to an uninformed or unsophisticated consumer, thereby allowing the latter to negotiate equally, or at least less unequally, with the commercial party. This type of legislation generally requires that the commercial party provide specified information in a form that the consumer can readily use, not only to understand the terms of a proposed transaction, but also to compare such terms with others available in the marketplace.

Remedial "consumer" legislation of the kind described above is almost invariably limited in its application to a specified group of persons considered to have need of a particular type of protection. For example, Part I of the *Consumer Protection Act*[1] deals with the registration of "itinerant" sellers.[2] Part II of the Act deals with specified "executory contracts" and provides that they must be in writing and that certain information, for example, with respect to the cost of borrowing in credit transactions, must be disclosed to the borrower.[3] The Act applies only to certain defined buyers. Section 1(d) of the Act defines "buyer" to mean "a person who purchases goods for consumption or services under an executory contract and includes his agent, but does not include a person who buys in the course of carrying on business or an association of individuals, a partnership or a corporation". The protections of the Act are, therefore, limited to individuals who buy goods for their own personal consumption, rather than for a business purpose.

Similarly, the protections established by the *Business Practices Act*[4] are limited to "consumers" whose involvement in the transaction in question is other than for business purposes. The term "consumer" is defined in section 1(b) to mean "a natural person but does not include a natural person, partnership or association of individuals acting in the course of carrying on business".

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[1] R.S.O. 1980, c. 87.

[2] See *ibid.*, s. 1(k), which provides:

> 1. In this Act,
>
> . . . .
>
> (k) 'itinerant seller' means a seller whose business includes soliciting, negotiating or arranging for the signing by a buyer, at a place other than the seller's permanent place of business, of an executory contract for the sale of goods or services, whether personally or by his agent or employee.

[3] *Ibid.*, ss. 19(1) and 24. These disclosure provisions are described *infra*, ch. 7, sec. 2(a)(i).

[4] R.S.O. 1980, c. 55.

The Act creates a scheme for the regulation of business practices in the sale of goods and services to consumers. It also establishes a means by which a consumer may seek relief where he or she has been subject to unfair practices by a seller of such goods or services. As with the *Consumer Protection Act* definition of "buyer", the assumption underlying the definition of "consumer" under the *Business Practices Act* is that such a purchaser of goods or services is less likely to be informed or to be in a position to bargain equally with the seller.

The federal *Bank Act*[5] governs the chartered banks, which are the major institutional lenders. The Act establishes mandatory requirements for the provision of standardized information to a certain class of borrowers. The actual disclosure requirements are prescribed by regulation.[6] Several different criteria are used by the *Bank Act* and regulations to determine the persons to whom disclosure must be made.

Disclosure is not required by the regulations if the loan amount exceeds $150,000.[7] The assumption underlying this criterion appears to be that an individual who borrows an amount in excess of $150,000 has no need of the special legislative protection respecting mandatory disclosure of information: presumably, only a financially sophisticated person, or a person with sophisticated legal or financial counsel, would borrow such an amount, in which case either that person, or his or her advisor, could be expected to handle the transaction without the protection described above. The *Bank Act* also excludes from the disclosure requirements loans that are made to a corporation or a partnership, and loans made to an individual for business purposes.[8] Here, presumably, the commercial nature of the borrower, or the commercial purpose of the loan, is the factor that has led to the determination that the mandatory disclosure of information is not needed.

3. DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

The history of the development of mortgage remedies has witnessed the periodic intervention by equity on behalf of borrowers in order to mitigate the harshness of the common law.[9] To some degree, then, mortgage law has developed its own particular kind of consumer protection. However, existing principles of mortgage law do not differentiate, for example, between the sophisticated commercial borrower and the individual, non-commercial borrower, whose level of financial or business experience, or power to negotiate with professional lenders, is limited. Nor is there any distinction currently made between loans secured by commercial property and those secured by residential property.

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[5] Being Part I of the *Banks and Banking Law Revision Act, 1980*, S.C. 1980-81-82-83, c. 40, as en. by s. 2 of the latter Act. See s. 202 of the *Bank Act*.

[6] S.O.R./83-103, s. 7. These disclosure requirements are described *infra*, ch. 7, sec. 2(a)(ii).

[7] S.O.R./83-103, s. 7(d).

[8] *Bank Act*, *supra*, note 5, s. 202(3)(e)-(f).

[9] *Infra*, ch. 8, sec. 2.

While the Commission acknowledges that, on one level, a land security agreement is just another form of commercial contract, we also recognize that this type of transaction can, in fact, differ from other commercial transactions. First, although a land security agreement usually involves a large amount of money, the borrower is very often unsophisticated in financial, business, and legal matters. For example, for the great majority of residential borrowers, a land security agreement is by far the most significant and complex financial relationship that they will ever enter into. The view, sometimes expressed, that there exists a true equality of bargaining power between institutional or professional lenders and residential borrowers does not reflect practical realities. Indeed, this conclusion is equally applicable in the case of many small commercial borrowers, whose financial acumen and knowledge may be no more profound than that of the average residential borrower.

Secondly, the Commission believes that the nature of the secured property can, itself, justify intervention in the security relationship, irrespective of the sophistication of the borrower in question. Our society has an important interest in promoting the stability of family life in a permanent residence. This recognition of the value of the family home, and of the significant disruptive impact and cost to individuals and families when a residence is lost, are factors that argue in favour of the creation of certain exceptions to the general principle of non-interference in land security transactions.[10]

4. DEVELOPMENTS IN THE UNITED STATES

The American Uniform Land Transactions Act[11] has created a scheme of special protections for a borrower who is a "protected party". Section 1-203(a) of the Act defines a "protected party" as follows:

> 1-203(a). 'Protected party' means:
>
> (1) an individual who contracts to give a real estate security interest in, or to buy or to have improved, residential real estate all or a part of which he occupies or intends to occupy as a residence;

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[10] An example of remedial, "consumer" legislation designed to protect the family residence is found in Part IV of the *Landlord and Tenant Act*, R.S.O. 1980. c. 232, which applies exclusively to residential tenancies. Part IV was enacted in response to the Ontario Law Reform Commission's 1968 *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies*, which had identified several areas of law and practice with respect to residential tenancies that the Commission considered to be in need of reform. The nature of the Commission's proposals generally reflected the fact that there existed a significant inequality of bargaining power between landlords and residential tenants. Most significantly, the financial and emotional strain experienced by a tenant in moving his or her residence gave a landlord considerable leverage over a tenant. Part IV was enacted to redress this imbalance of power.

[11] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

> (2) a person obligated primarily or secondarily on a contract to buy or to have improved residential real estate or on an obligation secured by residential real estate if, at the time he becomes obligated, that person is related to an individual who occupies or intends to occupy all or a part of the real estate as a residence; or
>
> (3) with respect to a security agreement, an individual who acquires residential real estate and assumes or takes subject to the obligation of a prior protected party under the real estate security agreement.

Section 1-203(b) defines "residential real estate" as real estate, improved or to be improved,[12] containing not more than three acres, and not more than four dwelling units. The term "residential real estate" does not include premises used for non-residential purposes where the borrower leases the premises to another party for such purposes. However, the borrower is free to carry on a commercial enterprise in premises that contain his or her residence and still retain the statutory protections accorded to a protected party.

The protections of the Act are not limited to the principal residence; rather, they apply to any residence. The Comment states that this extension of the protections to any residence is intended to simplify the process of determining whether a borrower has protected status at the time of the loan application. A lender need merely be satisfied that the property is occupied, or is intended to be occupied, as a residence; the lender will thereby avoid the difficulty in determining whether it is a primary or secondary residence.

The Comment to section 1-203 points out that the focus of the provision is on the residential nature of the secured property. Accordingly, these provisions differ from most other consumer protection statutes, which generally focus on the purpose for which the loan is to be used. The borrower's residence is subject to the statutory protections even if the money advanced has been used in a commercial venture.

Protected party status is also extended to a person who is either primarily or secondarily obligated on the security agreement, if such person is "related to" an individual who occupies, or intends to occupy, all or part of the property as a residence.

The concept of a related person is dealt with in section 1-204 as follows:

> 1-204. For purposes of giving meaning to the expressions 'individual related to' or 'person related to' a person is related to:
>
> (1) an individual if that person is
>
> (i) an organization directly or indirectly controlled by the individual, his spouse, or a relative by blood or marriage who shares the same residence with the individual;

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[12] The term "improved" is neither defined in the Act nor discussed in the Comment to the Act.

(ii) the spouse of the individual;

(iii) a brother, brother-in-law, sister, or sister-in-law of the individual;

(iv) an ancestor or descendant of the individual or of his spouse; or

(v) any other relative by blood or by marriage of the individual or of his spouse if the relative shares the same residence with the individual;

(2) an organization if that person is

(i) any other organization controlling, controlled by, or under common control with the organization; or

(ii) a person related to the person controlling the organization.

For example, a borrower may be a protected party, although he or she does not actually occupy the premises, if his or her child or parent occupies them as a residence. Similarly, a corporation would have the benefit of the statutory protections if the premises are occupied as a residence by an individual who controls the corporation. The intent of the latter provision is to protect individuals who are the *de facto* owners of the residence, but who use corporate status for tax or other purposes.

The scope of the definition of a protected party is relatively limited. It does not, for example, include a person who gives a security interest in a farm that contains a residence. However, this limited scope is likely explicable in light of the broad implications of the status of protected party under the Act. The Comment to section 1-203 enumerates a non-exhaustive list of the ways in which protected party status affects the rights and remedies of borrowers and lenders, as well as buyers and sellers of the property. The list deals, for example, with the effect of a seller's representations, waiver of warranties, modification of remedies, limitations on finance charges, and rights attendant upon possession and sale. Perhaps most significantly, the status of protected party confers immunity on a protected party against an action by the lender to recover any deficiency owing to him or her after a judicial or extra-judicial sale.[13] Clearly, a broad extension of the status of protected party would have serious implications in terms of the potential loss to lenders under the scheme established by the Act.

5. PROPOSALS FOR REFORM

The Commission has already endorsed generally the principle of freedom of contract and non-interference with secured transactions. However, we are also of the view that this general principle must be balanced against the needs of a certain class of borrowers for more information and for protection from overreaching by lenders. As outlined in the introductory chapter, the central aims underlying many of the Commission's recommendations in this Report are the protection of residential property and the provision of adequate information to residential borrowers, in order that they may bargain more effectively with lenders. Accordingly, the Commission recommends that the proposed *Land Security Act* should create a class of borrower, called a "protected borrower", in respect of whom special rights should be conferred.

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[13] See *infra*, ch. 9, respecting deficiency actions, and ch. 8, respecting the power of sale.

As we shall see, the essential obligations to be imposed on lenders *vis-à-vis* what we call protected borrowers relate to the disclosure of loan information and the requirement that disclosure statements and security agreements be written in plain language.[14] Protected status would also confer on the borrower certain extended possessory rights,[15] as well as the benefit of a reasonable waiting period prior to sale by the lender.[16] Protected borrower status would not, however, affect the lender's right to bring an action to recover the debt outstanding after the sale of the secured property,[17] as it does under the American Uniform Land Transactions Act.[18]

In determining who should be a protected borrower, the Commission has attempted to balance the need to protect borrowers against the need for administrative simplicity. Since the Commission will recommend enhanced disclosure of information requirements in favour of a prospective protected borrower, the Commission has sought a definition that a lender can apply at the early stage of inquiry or application by such a borrower, without complex or time-consuming investigation by the lender.

The Commission has come to the conclusion that any property that is occupied solely as a residence is worthy of the protections afforded by the proposals made later in this Report, regardless of the size or purpose of the loan that the property secures. We recognize that the extension of protected status to all persons giving a residence as security may mean that protection will occasionally be given to a financially sophisticated person who has no need of such protection. However, the value of the residence is not necessarily a measure of financial sophistication and bargaining power. The owner of a mansion will often have the same need of the proposed protections, particularly with respect to the lender's remedies on default, as does the owner of a modest bungalow. Furthermore, the use of this single criterion, namely, that the secured property is used as a residence, would simplify the lender's determination of protected borrower status at the outset of the loan relationship.

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[14] *Infra*, ch. 7.

[15] *Infra*, ch. 10.

[16] *Infra*, ch. 8.

[17] *Infra*, ch. 9.

[18] *Supra*, note 11, § 3-501. See *infra*, ch. 9, sec. 2(c).

Accordingly, the Commission recommends that a borrower should be a "protected borrower" if he or she resides in secured property that is a single family residence or residential unit, such as a condominium.[19] Our recommendation is intended to apply whether the secured property is a primary residence or a secondary residence, and regardless of the size or purpose of the loan.

However, we believe that it is not only strictly residential borrowers who require the proposed protections. In the Commission's opinion, the protections are also needed by a small businessperson or a farmer whose residence is part of a commercial property, multi-unit building, or farm given as security. With respect to farming in Ontario, the Commission rejects the view that the majority of farming operations have become large commercial enterprises and, therefore, need not be protected.

Nevertheless, the Commission recognizes that the extension of protected borrower status to all farms, commercial premises, and multi-unit dwellings, merely because the premises contain the borrower's residence, raises some difficult issues and would be inconsistent with the Commission's policy of non-interference with commercial transactions. There is no doubt, for example, that many farming operations are large scale and very sophisticated business enterprises, notwithstanding the fact that the owner's residence is located on part of the land. Similarly, large commercial or manufacturing premises conceivably may contain an apartment that the borrower occasionally occupies as a residence.

In the Commission's view, the concerns raised above can be addressed by using a combination of two criteria to determine protected borrower status: first, a requirement that the borrower occupy part of the premises as a residence; and, secondly, an upper loan limit, beyond which amount the protections would not apply. Accordingly, the Commission recommends that the definition of a protected borrower should include a borrower who resides on property that is either a farm, a commercial or manufacturing enterprise, or a multi-unit building of not more than five units, where such property secures a loan that does not exceed a specified amount. The loan amount limit should be prescribed by regulation and should be subject to adjustment on a regular basis to reflect inflation and market trends.[20]

We further recommend that protected borrower status should be accorded to a borrower who gives land as security for a loan in an amount less than an amount prescribed by regulation, irrespective of the nature of the secured property and irrespective of the purpose of the loan.[21] We would suggest $150,000 as an appropriate amount.

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[19] See the draft *Land Security Act* proposed by the Commission (hereinafter referred to as "draft Act"), *infra*, Appendix 1, s. 1.1.13(a).

[20] *Ibid.*, s. 1.1.13(b)-(d).

[21] *Ibid.*, s. 1.1.13(e).

The Commission believes that, while this amount is arbitrary to some degree, it generally represents an amount below which the borrower in question, whether residential or commercial, may not have legal or financial counsel and may need the proposed protections respecting the disclosure of information and the right to possession.[22]

We recognize that, particularly for combined-use property or where the loan is for a commercial purpose, the borrower will very often be a small personal corporation or partnership. Lenders almost invariably require personal guarantees in support of loans to such borrowers. The guarantors are usually the partners or controlling shareholders, often a husband and wife, who may occupy the residence on the property. In such circumstances, it is the individual guarantors, rather than the partnership or corporation, who are the *de facto* owners and, generally, the ultimate source of recovery of the debt. In the Commission's view, such persons also need the special protections proposed in this Report. Accordingly, we recommend that the definition of a protected borrower should also include a guarantor of a loan that is secured by exclusively or partially residential property, as described above, if the guarantor occupies the residence.[23]

Finally, we recommend that the definition of a protected borrower should include the spouse of the borrower and the spouse of the guarantor of the loan, as the term "spouse" is defined in section 1(1) of the *Family Law Act, 1986*,[24] where the borrower or guarantor is a protected borrower, if the spouse occupies the premises as a residence.[25] With respect to the inclusion of the borrower's spouse as a protected borrower, the Commission wishes to draw attention to section 19(1) of the *Family Law Act, 1986*, which provides that "[b]oth spouses have an equal right to possession of a matrimonial home". As we shall see, the decision to include a spouse as a protected borrower would give to the spouse certain special possessory rights, recommended later in this Report,[26] and, therefore, is consistent with the philosophy underlying section 19(1).

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[22] See *infra*, ch. 7, and ch. 10, sec. 1(d)(iii), respectively.

[23] Draft Act, s. 1.1.13.

[24] S.O. 1986, c. 4. Section 1(1) and (2) provides:

> 1.-(1) In this Act,
>
> . . . .
>
> 'spouse' means either of a man and woman who,
>
> (a) are married to each other, or
>
> (b) have together entered into a marriage that is voidable or void, in good faith on the part of the person asserting a right under this Act.
>
> (2) In the definition of 'spouse', a reference to marriage includes a marriage that is actually or potentially polygamous, if it was celebrated in a jurisdiction whose system of law recognizes it as valid.

[25] See the definition of "borrower" and "guarantor" in draft Act, s. 1.1.1 and s. 1.1.9, respectively.

[26] See *infra*, ch. 10, sec. 1(d)(iii).

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The *Land Security Act* should create a class of borrower, called a "protected borrower", in respect of whom special rights should be conferred.

2. The term "protected borrower" should be defined to mean:

   (a) a borrower who resides in secured property that is a single family residence or residential unit, such as a condominium, whether it is a primary residence or a secondary residence, and regardless of the size or purpose of the loan;

   (b) a borrower who resides in secured property that is either a farm, a commercial or manufacturing enterprise, or a multi-unit building of not more than five units, where such property secures a loan that does not exceed a specified amount, which should be prescribed by regulation and subject to adjustment on a regular basis to reflect inflation and market trends;

   (c) a guarantor of a loan that is secured by exclusively or partially residential property, as described above, if the guarantor occupies the residence;

   (d) a spouse of a borrower and a spouse of a guarantor of the loan, as the term "spouse" is defined in section 1(1) of the *Family Law Act, 1986*, where the borrower or guarantor is a protected borrower, if the spouse occupies the premises as a residence; or

   (e) a borrower who gives land as security for a loan in an amount less than an amount prescribed by regulation ($150,000 may be an appropriate amount), irrespective of the nature of the secured property and irrespective of the purpose of the loan.

CHAPTER 5

PRIORITIES AMONG SECURED CREDITORS

1. INTRODUCTION

For lenders, among the most important issues to arise in the mortgage context are those relating to priorities among secured interests, that is, the order in which two or more persons claiming interests in the same land are entitled to rank.[1] Questions respecting the value of the property, and the extent of prior secured claims against it, are central to a lender's decision to lend money on the security of that property. A lender will be unwilling to make a loan without some assurance that the total value of the loan is secured, so that the debt can be fully recovered in the event of the borrower's default. As a result, uncertainties and anomalies regarding priorities are of substantial significance to borrowers and lenders alike.

The law with respect to priorities as between registered security agreements is governed by either the *Registry Act*[2] or the *Land Titles Act*,[3] depending on the land registration system under which the land itself is registered. The rules governing competing unregistered security agreements have been developed by the common law and equity.[4] In the case of both registered and unregistered security agreements, the law of priorities generally appears to be operating satisfactorily. However, there remain a few issues that require clarification and reform.

2. PRIORITY FOR FUTURE ADVANCES

(a) PRESENT LAW

Of particular concern to the Commission are the difficulties that have arisen with respect to priorities in cases where a lender actually advances some or all the money to the borrower at some time subsequent to the registration of the security agreement. There will be occasions where a lender may not wish to advance, at one time, the full amount of the money that the loan agreement contemplates. For example, where the loan arrangement involves financing a construction project, the lender may wish to advance further moneys only when satisfied that the project has reached a certain agreed stage of completion. In other circumstances, a borrower may not want to draw the entire amount secured by the loan agreement until the money is actually needed, in order to avoid paying unnecessary interest charges; an illustration of such an agreement would be a revolving line of credit, whereby the borrower is entitled to draw funds up to a specified loan limit and to make payments on either a regular or intermittent basis. In all these cases of loans contemplating future advances, the issue of priority arises if the borrower gives a security interest to a second lender before the first lender makes a further advance of funds.

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[1] Burke (ed.), *Jowitt's Dictionary of English Law* (2d ed., 1977) defines "priority" as follows: "When two persons have similar rights in respect of the same subject-matter, but one is entitled to exercise his right to the exclusion of the other, he is said to have priority. The question is chiefly of importance with reference to securities on property."

[2] R.S.O. 1980, c. 445.

[3] R.S.O. 1980, c. 230.

[4] See, generally, Rayner and McLaren, *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 109-26.

A lender's priority for advances made after the borrower has given a subsequent security agreement depends on whether the first lender had actual notice of the subsequent security agreement when the further advance was made.[5] If the first lender did not have actual notice of the subsequent security agreement, the lender retains priority for all amounts advanced, up to the full amount for which the first agreement is expressed to be security. If the first lender has actual notice, the subsequent mortgage has priority over any further advances.[6]

The rationale for this rule was discussed in the leading House of Lords case of *Hopkinson v. Rolt*.[7] In that case, the Court, by a majority, reversed an earlier rule, established in *Gordon v. Graham*,[8] that a first lender has priority for all advances secured by a mortgage, including those subsequent in time to a second mortgage, notwithstanding that the first lender had notice of the second mortgage. In *Hopkinson*, Lord Chelmsford stated:[9]

> I do not feel restrained, therefore, by the deference which is justly due to Lord Cowper's high authority from questioning freely the doctrine which he is supposed to have sanctioned. The reason upon which the doctrine proceeds is, 'that it was the folly of the second mortgagee with notice to take such security.' Now, what is this but to say that a mortgagee, by taking a security for advances which may never be made, may effectually preclude a mortgagor from afterwards raising money in any other quarter? And, as the first mortgagee is not bound to make the stipulated further advances, and with notice of a subsequent mortgage, he can always protect himself by inquiries as to the state of the accounts with the second mortgagee, if he

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[5] *Hopkinson v. Rolt* (1861), 9 H.L.C. 514, 11 E.R. 829 (subsequent references are to 11 E.R.).

[6] This rule applies in both the land titles and registry systems in Ontario, and, in effect, has been codified in s. 68 of the *Registry Act*, *supra*, note 2, and s. 93(4) of the *Land Titles Act*, *supra*, note 3. An exception to the rule may exist if the lender is contractually obliged to make the advance: see *infra*, this sec.

[7] *Supra*, note 5.

[8] (1716), 2 Eq. Cas. Abr. 598, 22 E.R. 502 (Ch.).

[9] *Supra*, note 5, at 845.

> chooses to run the risk of advancing his money with the knowledge, or the means of knowledge, of his position, what reason can there be for allowing him any priority? What injustice is done to him by postponing him to the second mortgagee under such circumstances? But, on the other hand, if it is to be held that he is always to be secure of his priority, a perpetual curb is imposed on the mortgagor's right to encumber his equity of redemption.

Lord Cranworth took a dissenting view in *Hopkinson* and would have sustained the rule in *Gordon v. Graham*, giving full priority to all advances made pursuant to the first mortgage, regardless of notice. He stated:[10]

> Mortgages are but contracts; and when once the rights of parties under them are defined and understood, it is impossible to say that any rule regulating their priority is unjust. If the law is once laid down and understood, that a person advancing money on a second mortgage, with notice of a prior mortgage covering future as well as present debts, will be postponed to the first mortgagee, to the whole extent covered or capable of being covered by the prior security, he has nothing to complain of. He is aware when he advances his money, of the imperfect nature of his security, and acts at his peril.

While the rule in *Hopkinson* is stated in general terms to apply to all future advances, there remains some question whether the rule applies where a lender is contractually obliged to make such advances, or whether the rule governs only if future advances are made voluntarily by the lender after receiving notice of a subsequent encumbrance. It has been held in *West v. Williams*[11] that, even if the first lender was bound, without qualification, to advance the full loan amount, the first lender is not entitled to priority with respect to advances made after the receipt of notice of a subsequent security agreement. In *West*, the rationale given for this principle was that the lender would be entitled to treat the giving of a subsequent mortgage as constituting a breach of the loan agreement by the borrower, which would justify the lender in refusing to make the otherwise obligatory future advances.

However, a contrary view has been taken in *Kingsway Electric Co. Ltd. v. 330604 Ontario Ltd.*[12] In that case, an advance was made under an irrevocable line of credit secured by a mortgage, after the first lender had actual notice of a subsequent mortgage. In holding that the first lender retained priority for the advance, notwithstanding notice of the subsequent mortgage, Lovekin L.J.S.C. observed:[13]

> There is no hardship to the mortgagor when the mortgage is given to secure the collateral irrevocable letter of credit, for the first mortgagee does not have the option to make or withhold the advances which in this case are payments required to be made on demand without option under the letter of credit. The mortgagor

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[10] *Ibid.*, at 840.

[11] [1899] 1 Ch. 132.

[12] (1979), 27 O.R. (2d) 541, 1 R.P.R. 96 (H.C.J.) (subsequent reference is to 27 O.R. (2d)).

[13] *Ibid.*, at 548-49.

knows his line of credit and does not need to raise money on his equity of redemption. Indeed, all parties involved in transactions such as this should know precisely what their position is at all times if the distinction between voluntary and involuntary advances is clarified.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

The policy issues with respect to priorities for future advances are, in essence, the same as those addressed by the House of Lords over a century ago in *Hopkinson v. Rolt.*[14] The judges in both the majority and the minority in that case appeared to be of the view that, provided the priority rule was settled and clear, neither choice of rule could be said to be unjust to either the first or second lender. If the rule favoured by the majority in *Hopkinson* applied, the first lender could simply refuse to make any further advances upon receiving actual notice of a subsequent encumbrance. If, on the other hand, the rule advocated by the minority was sustained, the second lender would know the full extent of the first lender's potential priority, and could choose to lend or not lend on the basis of the borrower's residual equity in the property. The decision of the majority in *Hopkinson* was based on a concern for the borrower's freedom to obtain financing on the strength of his equity of redemption.

Nevertheless, difficulties for both lenders and borrowers still arise with respect to the existing rule that a lender retains priority only for advances made prior to actual notice of a subsequent encumbrance. A lender may not want to be forced by a borrower into the position of refusing to make further advances, since, in so doing, that lender may also lose all or part of the benefit of the agreement. As we have observed, very often such agreements secure construction loans, whereby moneys are advanced as the building progresses. The actual value of the first lender's security is, therefore, tied to the satisfactory progress of the construction. If the building is only partially completed when the first lender is forced to refuse further involvement in the project, the first lender may be denied his or her legitimate expectations under the agreement.

As a further example, advances may be made pursuant to a revolving loan, or line of credit, agreement, up to an express maximum amount. This kind of financing is particularly common with small commercial borrowers. The nature of these arrangements is such that there are frequent payments and advances, and the balance of the debt due often changes daily. A lender may be less willing to enter into such credit arrangements under present law, since there is a possibility that the borrower may draw on the account after notice is received by the first lender, but before the account can be frozen, thereby leaving the debt partially unsecured.

Under the existing rule, yet another difficulty may arise with respect to variable rate mortgages that provide for fixed monthly payments. Where interest rates rise, the increased cost attributable to the higher interest is added to the overall debt. Such adjustments are, at least notionally, tantamount to future advances and it is arguable that a first lender who has notice of a subsequent encumbrance would not have priority for increased interest amounts added to the outstanding balance after notice of a subsequent encumbrance.[15]

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[14] *Supra*, note 5.

Lenders have argued that the existing rule is not responsive to these varied and more complex financial transactions and that, accordingly, the rule discourages flexible and innovative security arrangements. However, the concern that led to the existing choice of rule remains. If the rule were reversed, and the first lender were given priority for the full expressed amount of the loan, a borrower might have difficulty in arranging alternative financing in circumstances where the first lender refused to advance further amounts.

(c) THE LAW IN OTHER JURISDICTIONS

(i) British Columbia

In British Columbia, the rule regarding priority for future advances is governed by section 24 of the *Property Law Act*,[16] which abolishes the common law rules concerning tacking and replaces them with a set of statutory rules. Section 24(1) of the Act requires that all advances for which priority may be claimed must be "contemplated by and in accordance with the mortgage". Section 24 establishes priorities with respect to subsequent mortgages and judgments, but is otherwise silent with respect to other types of competing interests.

Section 24(1) essentially codifies the rule in *Hopkinson v. Rolt*.[17] A lender retains priority for future advances where one or more of the following conditions are satisfied:

(a) the subsequent mortgagee or judgment holder had entered into a subordination agreement;

(b) the first mortgagee had received no notice in writing that the intervening interest had been registered;

(c) the intervening interest had not been registered; or

(d) the mortgagee is contractually bound to make the further advances.

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[15] *Reynolds Extrusion Co. Ltd. v. Cooper* (1978), 21 O.R. (2d) 416 (H.C.J.) was concerned with the effect of amendments to a prior mortgage without the consent of a subsequent encumbrancer. Grange J. implicitly accepted that the first lender retained priority for interest adjustments made on variable rate mortgages, the apparent rationale being that a subsequent encumbrancer takes with notice of such possible adjustments. However, the argument that such adjustments might constitute a further advance was not raised.

[16] R.S.B.C. 1979, c. 340.

[17] *Supra*, note 5.

The Law Reform Commission of British Columbia recently considered the issue of priorities for future advances in its *Report on Mortgages of Land: The Priority of Further Advances*.[18] The British Columbia Commission reviewed the competing policies that were articulated in *Hopkinson v. Rolt*, and recommended that the rule in that case should continue to prevail, subject to two exceptions. The first exception related to further advances made under a mortgage that secured a revolving, or "running", account. The second exception related to further advances made under a "construction" mortgage.

The British Columbia Commission was of the view that conferring priority for all future advances on a running account would encourage the granting of credit, particularly to small businesspersons.[19] It observed that the existing rule creates complexity in accounting arrangements, particularly in cases where a second mortgage also secures a running account.[20] It was satisfied that a borrower would not be disadvantaged in seeking alternative financing, in the event that the first lender refused to make further advances, since the borrower in such a case would have the right to pay down the mortgage to a nil amount, and then, pursuant to section 24(2) of the *Property Law Act*, compel the lender to execute and deliver a registrable discharge. Since subsequent lenders would be aware of the first lender's priority for the revolving amount, they would be able, and could be expected, to govern themselves accordingly in determining whether or not to make the subsequent loan.[21]

The British Columbia Commission then considered whether such an exception to section 24 should also be made with respect to registered judgments. For the following reasons, the British Columbia Commission decided that it should not:[22]

> If the new priority rule we propose extended to priority over judgments, the borrower would, in effect, be permitted to 'hide behind' the mortgage lender so as to defeat or impair the rights given to the judgment holder under the *Court Order Enforcement Act*. The priority rule proposed diminishes the priority of encumbrancers whose rights arise by agreement with the borrower. So long as the rules are well understood, that cannot be said to work a hardship. But the holder of a judgment who has registered it against the mortgaged property is, in a sense, a non-consensual mortgagee and to dilute his priority rights is arguably bad policy.

Accordingly, the British Columbia Commission recommended as follows:[23]

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[18] Law Reform Commission of British Columbia, Report No. 85, *Report on Mortgages of Land: The Priority of Further Advances* (1986).

[19] *Ibid.*, at 16.

[20] *Ibid.*, at 17.

[21] *Ibid.*, at 18.

[22] *Ibid.*, at 20.

[23] *Ibid.*, at 21.

> Section 24 of the *Property Law Act* be amended to provide that, notwithstanding subsection (1), where a mortgage is expressed to be made to secure a current or running account, the mortgagee shall, for all further advances made under the mortgage up to a maximum amount stated in the mortgage, have priority over any subsequent mortgagee.

The British Columbia Commission also recommended that a further exception to the existing rule be made with respect to construction mortgages.[24] It observed that, because of the peculiar nature of construction financing, the implications for a construction lender of the existing rules concerning priority for further advances can be of greater significance than for other lenders.[25]

The British Columbia Commission explained that, frequently, while a building is under construction, the value of the security is worth less than the amount that it has been necessary to advance. For example, a lender might have advanced half the money contemplated by a construction mortgage that, at the time of the latest advance, is secured by the value of the land and a half-completed building; however, since a half-completed building may be worth little more than no building, a lender will want to be in a position to make further advances in order to complete construction, so that the value of the security will match or exceed the total amount advanced. The Commission emphasized that the completion of construction is generally to the advantage of all persons having an interest in the property, including subsequent encumbrancers and builder's lien claimants.[26]

Accordingly, in order to encourage a greater willingness on the part of commercial lenders to make money available for construction purposes, the Commission recommended that section 24 of the *Property Law Act* be amended to provide that a lender should have priority with respect to any advance made under a construction mortgage, after its registration, up to the maximum amount stated in the mortgage, if the advance was made *bona fide* for the purpose of enabling the completion of the improvement on the land.[27] This priority would be given with respect to all subsequent encumbrancers, including subsequent lenders, builder's lien claimants, and judgment holders. The term "construction mortgage" would be defined to mean "a mortgage which is clearly expressed to be a 'construction mortgage' and that secures an obligation which the mortgagor incurred for the purpose of making an improvement on the land over which the mortgage has been granted".[28]

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[24] *Ibid.*, at 30.

[25] *Ibid.*, at 22.

[26] *Ibid.*

[27] *Ibid.*, at 30.

[28] *Ibid.*

(ii) United States

Section 3-205 of the Uniform Land Transactions Act[29] provides that obligations secured by a security agreement may include future advances or other future obligations, whether or not the advances or obligations were made or incurred pursuant to a commitment.[30] However, the maximum amount of the advance or obligation secured may not exceed the maximum amount stated in the agreement, subject to two exceptions. The Act provides that, if the further advance is made in reasonable protection of the property, such as payments for taxes, insurance, or maintenance charges under a condominium agreement, or to enable completion of a contemplated improvement, such advances are secured, even though the agreement does not expressly provide for future advances, and even though the advances cause the total of future advances to exceed the maximum amount stated in the agreement.

While section 3-205 of the Act provides for the *attachment* of security with respect to future advances, the rules governing *priorities* between conflicting security interests that involve future advances are dealt with in section 3-301. The Act provides that a lender retains priority for advances made after the borrower has given a subsequent security interest, up to the maximum amount stated in the agreement, in two cases: (1) if the advance was made pursuant to a commitment, where that commitment was entered into before the secured party had knowledge of the intervening interest; and (2) in the case where the advance was not made pursuant to a commitment, where the advance was made before the lender had knowledge of the intervening interest. The latter rule is, in essence, analogous to the existing rule in Ontario: notice to the first lender of the subsequent mortgage limits the first lender's priority to the amount advanced prior to such notice.

The Act uses, but does not define, the concept of "knowledge" by the first lender. It is unclear whether it would be sufficient under section 3-301 for the lender to have constructive notice by, for example, registration of the intervening security agreement, or if there must be actual notice to the first lender, as required in Ontario.

Under section 3-301(b)(3) and (4), even if a first lender has knowledge of an intervening interest, priority will be retained for future advances that are made for the reasonable protection of the security or, if made under a secured construction loan agreement, in order to complete the project. The first lender has priority for such amounts in these circumstances even if the advances exceed the total amount stated in the agreement.

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[29] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

[30] *Black's Law Dictionary* (5th ed., 1979) defines "commitment" as "an agreement or pledge to do something; e.g. a statement by a lender that a loan will be made under certain terms. Commitments may be of various types, that is, a conditional commitment, subject to certain items being met, or a firm commitment which is binding on the lender without conditions." Presumably, the drafters of the Act intended that the security should attach whether or not the lender was legally obligated to make the advance, that is, whether or not the advance was "voluntary".

(d) PROPOSALS FOR REFORM

(i) The General Rule

In determining whether the first lender should have priority for all future advances made pursuant to a security agreement, the Commission has sought a rule that will allow the greatest flexibility in commercial arrangements and encourage innovative financing, without sacrificing the interests of borrowers.

Accordingly, we recommend that, subject to further recommendations made in the next section, the following rules should govern a lender's priority for advances made pursuant to a registered security agreement that expressly contemplates future advances.

Two situations are envisaged. Where the amount loaned is expressed to be a fixed amount, the priority should be for the amount outstanding under the security agreement, so long as the total amount advanced does not exceed the express amount under the agreement.[31] Where the agreement contemplates future advances on a revolving basis, the lender should have priority for the amount outstanding, up to the maximum amount of credit expressed in the agreement, even though the cumulative total of advances made under the agreement exceeds the amount for which the agreement is expressed to be a security.[32] In both cases, the lender should have priority whether or not he or she has notice of a subsequent encumbrance.[33]

A few illustrations of the operation of our proposals seem appropriate. With respect to the first situation envisaged by our proposals, dealing with a loan of a fixed amount, let us assume that the security agreement provides for a loan of $50,000, to be advanced by instalments. Assume that the lender advances $45,000 and the borrower then pays back $10,000. At this juncture, when the outstanding balance is $35,000, the lender makes a further advance of $5,000. As a result, the total amount advanced is $50,000 ($45,000 + $5,000), and the outstanding balance is $40,000 ($45,000 – $10,000 + $5,000). The lender's priority would be for $40,000, that is, the amount outstanding under the agreement. The total amount advanced, and, therefore, the amount outstanding, does not exceed the express amount fixed under the security agreement.

To give another example, let us assume a fixed loan amount of $50,000, an initial advance of $45,000, and a payment by the borrower of $10,000. As in the above example, the outstanding balance is $35,000. But assume that, for some reason, the lender then advances a further $10,000. Accordingly, the total amount advanced would be $55,000 ($45,000 + $10,000), and the outstanding balance would be $45,000 ($35,000 + $10,000). In this example, the lender's priority would still be for $40,000, since $5,000 of the $55,000 actually advanced would not have priority; it would represent the amount by which the total amount advanced exceeds the express amount fixed under the security agreement.

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[31] See the draft *Land Security Act* proposed by the Commission, *infra*, Appendix 1 (hereinafter referred to as "draft Act"), s. 3.12(3)-(6), esp. s.s. (5).

[32] *Ibid.*

[33] *Ibid.*, s. 3.12(4).

With respect to the second situation envisaged by our proposals, dealing with agreements contemplating future advances on a revolving basis, let us assume that the borrower's line of credit is $50,000, the lender first advances $45,000, and the borrower pays back $10,000. At this stage, when the outstanding balance is $35,000, the lender advances a further $15,000. The amount outstanding is now $50,000 ($35,000 + $15,000), while the total amount actually advanced is $60,000 ($45,000 + $15,000). Under our proposals, the lender's priority would be for $50,000, since priority would be given only up to the maximum amount of credit expressed in the security agreement. Even if the lender's second advance had been, for example, $16,000 instead of $15,000, making the outstanding balance $51,000, the lender's priority would still be for $50,000, since, as we have said, in no case may the amount of the priority exceed the credit limit expressed in the agreement.

(ii) Exceptions to the General Rule

a. Construction Lien Claimants

We recommend that our proposal respecting priorities for future advances should be subject to Part XI of the *Construction Lien Act, 1983*,[34] which establishes, among other matters, a statutory scheme of priorities between lenders and construction lien claimants. The policy consideration that led the Law Reform Commission of British Columbia to recommend that lenders should have priority over builder's lien claimants with respect to subsequent advances made under a construction mortgage for the completion of the improvement — that is, that the completion of the improvement will benefit all persons having an interest in the property — has already been addressed in Ontario by the *Construction Lien Act, 1983*. Part IX of that Act provides a mechanism for the appointment of a trustee who may, among other things, complete the improvement or take any appropriate steps for the preservation of the premises. Section 80(7) of the Act provides that, where a trustee obtains financing for any of the purposes set out in Part IX of the Act, the lender of those moneys obtains priority over every lien existing at the date of the trustee's appointment.

b. Judgment Creditors

The Commission has also considered whether an exception with respect to judgment creditors should be made to the general rule governing priorities for future advances. As we have discussed,[35] the Law Reform Commission of

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[34] S.O. 1983, c. 6, s. 80.

[35] *Supra*, this ch., sec. 2(c)(i).

British Columbia has recommended that such an exception should be made, in order to prevent borrowers from "hiding behind" the priority of their lenders.

While we share the British Columbia Law Reform Commission's concern with respect to this possible disadvantage to judgment creditors, we believe that a judgment creditor could obtain the same practical result as contemplated by the proposed exception by serving a garnishment order on the lender with respect to any further advances that might be made to the borrower.[36] A lender in such a position could either refuse to make the advance to the borrower, or could satisfy the garnishment order and add the amount so paid to the borrower's secured debt. Accordingly, we believe that no exception should be made to the general rule with respect to judgment creditors.

c. *Payments in Protection of the Property*

For a variety of reasons, a first lender will occasionally find it necessary to make certain payments in order to protect the secured property. For example, the lender may pay outstanding property taxes or insurance premiums where the borrower has failed to do so. We believe that it would be fair and reasonable for a lender to have both security and priority for such amounts, even though the security agreement does not expressly contemplate them, since the protection of the secured property is of benefit to all persons having an interest in that property.

Accordingly, while we have recommended that the priority claimed at any time by a lender, whether for a fixed or revolving loan, should be limited in the manner described above, we believe that there should be a further exception to this general rule. We recommend that a lender should be secured and have priority for future advances, even though the agreement does not expressly contemplate future advances and even though the advances exceed the total express loan amount, where those amounts are advanced for the reasonable protection of the secured property, for example, for such expenses as property taxes, insurance premiums, condominium maintenance fees, and commercially reasonable repairs.[37]

(iii) Refusal to Advance

As we have discussed, the major concern with giving the first lender priority for the entire express amount of a loan to be made by future advances is the potential restriction this rule could have on the borrower's ability to obtain alternative financing if the first lender refuses to make further advances needed by the borrower. We recognize that, in order to obtain such financing, the borrower must have a means to assure a prospective alternative lender of the actual amount that is outstanding at the time the first lender refuses further advances, and to limit the first lender's priority to the amount actually advanced at the date of the lender's refusal to make further advances.

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[36] Rules of Civil Procedure, O. Reg. 560/84, r. 60.08.

[37] Draft Act, s. 3.12(3), (5) and (6).

Accordingly, we recommend that a lender's priority should be fixed at the date of his or her refusal to make further advances and should not exceed the amount actually outstanding under that agreement.[38] In order to establish the actual amount of the lender's priority to the satisfaction of a prospective subsequent lender, the borrower should be entitled to register a notice in prescribed form stating that the lender has refused to make further advances, and stating the amount of the outstanding indebtedness.[39] The notice should be served on the lender in the manner proposed later in this Report.[40]

The lender should be entitled to register against title a notice of dispute, as prescribed by regulation. The lender may dispute the borrower's notice concerning the lender's refusal to make further advances or concerning the amount stated to be due under the security agreement.[41] The notice should be served on the borrower.[42] If the lender fails to register a notice of dispute within ten business days after registration of the notice by the borrower, the information contained in the borrower's notice should be deemed to be correct and binding on the lender for the purpose of limiting the lender's priority.[43] Where the lender does register a notice of dispute, the matter should be resolved by application to the court. Either party should be entitled to register the court order, and that order should be conclusive of the matters determined therein.[44]

Finally, we recommend that, where the notice by the borrower or the lender contains a statement that the maker of the statement knows or ought to know is incorrect, that party should be liable to any person for any loss or damage caused thereby.[45]

3. PRIORITY ON RENEWAL

(a) PRESENT LAW

A security agreement will very often give the borrower an option to renew the agreement, usually on the same terms, but at an adjusted rate of interest. Where a subsequent encumbrance has been registered, the first lender will be entitled to priority on renewal for the amount outstanding under the original agreement at the date of renewal. The lender will not, however, have priority for any increased interest amount, even though the original agreement expressly contemplated such an increase.[46]

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[38] *Ibid.*, s. 3.13(1).

[39] *Ibid.*, s. 3.13(2).

[40] *Ibid.*, s. 3.13(3). See *infra*, ch. 11, sec. 2.

[41] Draft Act, s. 3.13(6).

[42] *Ibid.*, s. 3.13(7). See *infra*, ch. 11, sec. 2.

[43] Draft Act, s. 3.13(10).

[44] *Ibid.*, s. 3.13(12)-(13).

[45] *Ibid.*, s. 3.13(5) and (9).

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

Where a second encumbrance has been registered, the first lender will be reluctant to renew the security agreement without the assurance that he or she will have priority for the whole amount due, including the increased interest amount. If the first lender refuses to renew, the borrower may have a difficult time obtaining alternative financing. An alternative lender will not be able to assume the first lender's priority position for the loan amount, including principal and interest, without a written postponement agreement from the second lender. Whether seeking renewal with the first lender, or seeking alternative financing where the first lender refuses to renew, the borrower will be in the unenviable position of having to negotiate such an agreement with the second lender. These negotiations almost invariably will result in increased costs to the borrower. We can expect most commercial borrowers to be capable of negotiating such matters without much difficulty. However, a protected borrower, particularly a residential borrower, may be at a greater disadvantage.

(c) PROPOSALS FOR REFORM

We believe that the right to renew a security agreement can be an important one to a protected borrower. Indeed, this right is often reflected in the interest rate that he or she pays. Such borrowers generally do not expect any problems to arise when they seek to exercise the right of renewal. Where the right of renewal is expressly contemplated in the security agreement, a subsequent encumbrancer has notice of a possible increase in the interest or principal amount or the amendment of other terms upon renewal, and, therefore, the subsequent encumbrancer can govern himself or herself accordingly when negotiating with the borrower for the second security agreement.

Accordingly, we recommend that where a borrower is a protected borrower,[47] and where the security agreement expressly contemplates renewal upon maturity of the agreement, the lender should be entitled to priority for the renewed amount, including any increased interest amount, so long as the lender has renewed the security agreement on the terms expressly set out in the agreement.[48]

We recognize that a subsequent encumbrancer may respond to legislation implementing this recommendation by including in the security agreement the right to call the loan where there is a renewal of the original agreement on terms that the encumbrancer considers to be unfavourable to his or her position. It can be expected that the subsequent encumbrancer will use this type of clause whenever interest rates have risen, in order to require the borrower to renegotiate the loan at a higher interest rate. We believe that a protected borrower should not be placed in such a position, since it would effectively render nugatory the preceding recommendation. The subsequent encumbrancer has notice of the possible renewal on the terms specified in the original agreement and should make his or her decision to provide financing for the agreed term of the second security agreement at the time when the borrower enters into that agreement. Accordingly, we recommend that a clause in a security agreement should be void if it requires, or entitles the lender to require, the borrower to pay the amount due under the agreement where a prior security agreement is renewed in accordance with its terms.[49]

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[46] *Reynolds Extrusion Co. Ltd. v. Cooper*, *supra*, note 15, and *Credit Foncier Franco Canadien v. 253171 Alberta Ltd.* (1984), 33 Alta. L.R. (2d) 276, 57 A.R. 24 (Q.B.).

[47] See *supra*, ch. 4.

[48] Draft Act, s. 3.12(7).

4. UNREGISTERED STATUTORY PRIORITIES

One kind of priority claim that troubles lenders is the unregistered lien in favour of the Crown or a public body for an amount owing to it by the owner of land. In 1971, this Commission recognized the significance of unregistered statutory liens that have priority over registered interests, particularly to persons who have a security interest in land and who may be unaware of such liens until default or sale by the borrower.[50] One such unregistered statutory lien continues to be of particular concern to lenders. Section 30(1) of the *Public Utilities Act*[51] creates a lien in favour of a municipal corporation or a public utility or hydro-electric commission with respect to moneys payable for public utilities supplied to the property. Until 1982, the lien had been limited to a maximum of the amount owing for a period of three months. An amendment in 1982 removed this limitation and conferred priority for such liens for an indefinite period. The apparent rationale for extending the priority was to reduce or remove the incentive to withdraw utilities, especially during winter months, where an owner failed to make the requisite payments.

Lenders consider the 1982 amendment to be both unfair and unnecessary. Their concern is that a lender's secured position could be jeopardized if amounts owing for public utilities are allowed to accumulate on an unlimited basis without notice to lenders. Lenders are anxious for there to be some mechanism that would allow them to determine whether moneys are owing in respect of utilities supplied to the property, and, if so, in what amount; in this way, they would be in a position either to ensure payment by the owner or to take appropriate steps if nonpayment constitutes default under the security agreement. To determine the current state of account with the borrower, they must now constantly monitor the property by making regular inquiries of the appropriate bodies.

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[49] *Ibid.*, s. 5.3(7)(e).

[50] Ontario Law Reform Commission, *Report on Land Registration* (1971), at 37-41. The Commission recommended that such liens be registered on title, with the exception, for example, of liens in respect of municipal taxes.

[51] R.S.O. 1980, c. 423, s. 30(1), rep. and re-en. by S.O. 1982, c. 45, s. 1.

It has been suggested that public utilities should be required to give notice to lenders of moneys owing for a period of more than three months. However, this suggestion may be impracticable and too costly, since such utilities would be required to determine, on a regular basis, who has a security interest in the property.

Lenders have suggested that an alternative would be a scheme analogous to the notice requirements established with respect to condominium common expense payments. Under the *Condominium Act*,[52] the condominium corporation has a lien for unpaid common expenses. Section 33(1) gives the corporation priority for the lien over every registered and unregistered encumbrance, notwithstanding that such encumbrance existed prior to the date on which the lien arose.[53]

The lien expires three months after the default that gave rise to it, unless notice of the lien is registered against the land by the corporation.[54] Any person acquiring or proposing to acquire an interest in a condominium unit, including a lender, can request a certificate from the corporation containing a binding statement in respect of the amount unpaid for common expenses.[55] If a corporation fails to give such a certificate within seven days of the request, the corporation is deemed to have given a certificate stating that no default has occurred.[56] A subsequent encumbrancer is then free to act on the basis that no amounts are due to the corporation.

The Commission does not propose, at this time, any solution to the problem raised by the lien in respect of moneys owing for public utilities supplied to the secured property. As we have discussed, the Commission's *Report on Land Registration*[57] dealt with the problem of unregistered liens and recommended reform legislation that, generally speaking, would resolve the matter by abolishing liens not properly registered on title. The Commission raises the issue of priority of liens under the *Public Utilities Act* simply as an example of a much larger problem that should more properly be the subject of consideration by the Land Registration Management Committee (often referred to as the POLARIS Committee), created in September 1972 by the Ontario Ministry of Consumer and Commercial Relations to deal with land registration in this Province.[58]

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[52] R.S.O. 1980, c. 84.

[53] *Ibid.*, s. 33(2). This section creates certain exceptions, including claims of the Crown, other than by way of a mortgage, and claims for taxes, charges, rates, and assessments levied or recoverable under certain statutes.

[54] *Ibid.*, s. 32(5).

[55] *Ibid.*, s. 32(8).

[56] *Ibid.*, s. 32(9).

[57] *Supra*, note 50.

[58] See, for example, Ontario, Ministry of Consumer and Commercial Relations, Property Rights Division, Land Registration Management Committee, *An Improved Land Registration System for Ontario*, Vols. 1, 2, and 3 (August 1979). This Report completed the

RECOMMENDATIONS

The Commission makes the following recommendations:

1. (1) Subject to paragraphs (2) and (3), the following rules should govern a lender's priority for advances made pursuant to a registered security agreement that expressly contemplates future advances:

    (a) where the amount loaned is expressed to be a fixed amount, the priority should be for the amount outstanding under the security agreement, so long as the total amount advanced does not exceed the express amount under the agreement;

    (b) where the agreement contemplates future advances on a revolving basis, the lender should have priority for the amount outstanding, up to the maximum amount of credit expressed in the agreement, even though the cumulative total of advances made under the agreement exceeds the amount for which the agreement is expressed to be a security; and

    (c) in the cases contemplated by subparagraphs (a) and (b), the lender should have priority whether or not he or she has notice of a subsequent encumbrance.

    (2) The recommendations in paragraph (1) should be subject to Part XI of the *Construction Lien Act, 1983*.

    (3) The recommendations in paragraph (1) should be subject to a further exception respecting payments made to protect the secured property. That is, a lender should be secured and have priority for future advances, even though the security agreement does not expressly contemplate future advances and even though the advances exceed the total express loan amount, where those amounts are advanced for the reasonable protection of the secured property, for example, for such expenses as property taxes, insurance premiums, condominium maintenance fees, and commercially reasonable repairs.

2. With respect to the situation where, in the case of a loan contemplating future advances, the lender refuses to make such advances:

    (a) the lender's priority should be fixed at the date of his or her refusal to make further advances and should not exceed the amount actually outstanding under the security agreement;

POLARIS (Province of Ontario Land Registration and Information System) project. See, now, *Land Registration Reform Act, 1984*, S.O. 1984, c. 32, discussed, in part, *supra*, ch. 2, sec. 2(b).

(b) in order to establish the actual amount of the lender's priority to the satisfaction of a prospective subsequent lender, the following rules should apply:

   (i) the borrower should be entitled to register a notice in prescribed form stating that the lender has refused to make further advances, and stating the amount of the outstanding indebtedness;

   (ii) the notice should be served on the lender (see chapter 11, Recommendations 2(1) and (2)(a));

   (iii) the lender should be entitled to dispute the borrower's notice concerning the lender's refusal to make further advances or concerning the amount stated to be due under the security agreement by registering against title a notice of dispute, as prescribed by regulation;

   (iv) the notice should be served on the borrower (see chapter 11, Recommendations 2(1) and (2)(b));

   (v) if the lender fails to register a notice of dispute within ten business days after registration of the notice by the borrower, the information contained in the borrower's notice should be deemed to be correct and binding on the lender for the purpose of limiting the lender's priority;

   (vi) where the lender registers a notice of dispute, the matter should be resolved by application to the court; and

   (vii) either party should be entitled to register the court order, and that order should be conclusive of the matters determined therein; and

(c) where the notice by the borrower or the lender contains a statement that the maker of the statement knows or ought to know is incorrect, that party should be liable to any person for any loss or damage caused thereby.

3. Where a borrower is a protected borrower, and where the security agreement expressly contemplates renewal upon maturity of the agreement, the lender should be entitled to priority for the renewed amount, including any increased interest amount, so long as the lender has renewed the security agreement on the terms expressly set out in the agreement.

4. A clause in a security agreement should be void if it requires, or entitles the lender to require, the borrower to pay the amount due under the agreement where a prior security agreement is renewed in accordance with its terms.

5. Priority problems raised by the existence of unregistered liens in favour of the Crown or a public body for an amount owing to it by the owner of land, dealt with in the Commission's 1971 *Report on Land Registration*, should be considered by the Land Registration Management Committee of the Ministry of Consumer and Commercial Relations.

CHAPTER 6

SUBSTANTIVE RIGHTS OF THE PARTIES

1. THE BORROWER'S RIGHT TO PREPAY THE LOAN

(a) INTRODUCTION

For any one of a variety of reasons, whether it be a fluctuation in interest rates, a change in financial circumstances, or a desire to sell secured property free of any encumbrance, a borrower may wish to prepay, and therefore discharge before maturity, the existing mortgage on his or her property. A lender, on the other hand, ordinarily will have an incentive to resist prepayment by the borrower, unless the lender can relend the money at a higher rate of interest. Moreover, a lender generally will prefer to avoid the administrative inconvenience of renegotiating a new loan, even when the lender is able to recoup the expenses from the borrower. The Commission recognizes the frequently competing interests in this area and, as a result, has sought to balance the borrower's desire for flexibility in dealing with the secured property with the lender's legitimate expectations respecting the return on the investment.

(b) PRESENT LAW

At common law, a borrower has no right to prepay the mortgage debt, apart from any contractual right given by the mortgage.[1] A lender is not required to accept any tender of payment or to provide the borrower with a discharge, except where this is expressly provided for by the terms of the mortgage.

However, in Ontario, a borrower has certain limited statutory rights of prepayment under section 17 of the Ontario *Mortgages Act*[2] and section 10 of the federal *Interest Act*.[3] These sections basically provide that, where a mortgage has a term of more than five years, and where the mortgage has been in existence for at least five years, the borrower may pay the principal and interest due, together with a bonus of three months' interest in lieu of notice,[4] in order to stop the running of interest on the loan. The borrower does not, however, have a right to obtain a discharge from the lender simply on such prepayment.[5]

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[1] *Knightsbridge Estates Trust, Ltd. v. Byrne*, [1939] Ch. 441, aff'd [1940] A.C. 613, [1940] 2 All E.R. 401 (H.L.).

[2] R.S.O. 1980, c. 296.

[3] R.S.C. 1970, c. I-18.

Since these limited provisions, relating as they do to mortgages for more than five years, are largely anachronistic in the existing mortgage market, they have little practical effect. The provisions were enacted in an era of stable interest rates and mortgages with terms of up to twenty-five years. A mortgage of more than five years has been unusual for some time now, although the availability of such mortgages is becoming increasingly common once again. The statutory provisions are now triggered in favour of a borrower only when, largely through inadvertence, the lender is caught by a term longer than five years, or by a renewal that does not preserve the lender's rights to stay outside the statutory prepayment provisions.[6]

In addition to the provisions described above, under section 16 of the *Mortgages Act* a borrower in default is entitled to pay to the lender the principal amount secured by the mortgage, as well as three months' interest. This statutory right applies notwithstanding any agreement to the contrary.

Apart from these statutory provisions, and apart from any right conferred by the terms of the mortgage, the lender can refuse to accept the amount outstanding or can demand a prepayment penalty, even though the amount that the borrower tenders could be relent by the lender at a higher rate of interest.

If the issue of prepayment is analyzed from a strictly contractual point of view, the borrower's payment of the loan at a date earlier than that provided for in the security agreement can be considered a breach of that agreement. If ordinary contractual principles were to apply, upon such a breach of contract, a lender usually would be entitled to damages representing what he or she would have had if the contract had been performed.[7] In other words, the lender would be entitled to compensation for actual damages only, after which the lender would be compelled to give a discharge. In some cases, such as where interest rates have fallen, the damages suffered by a lender may be substantial; but, in other cases, there may be no damages at all.

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[4] Payment of the bonus cannot be avoided by notice to the lender in advance of the borrower's intention to prepay: *Payment v. Prudential Ins. Co. of Amer.* (1959), 28 W.W.R. 197 (Alta. Dist. Ct.).

[5] With respect to a borrower's right to obtain a judicial discharge, see s. 11 of the *Mortgages Act*, *supra*, note 2, discussed *infra*, this ch., sec. 2(a).

[6] For example, assume that a mortgage is executed on July 18, 1973. Assume, as well, that the date from which interest is to accrue is August 1, 1973, and that the maturity date is August 1, 1978. It has been determined that the "date of the mortgage" for the purpose of prepayment rights is the date of execution, not the adjustment date; accordingly, in the above illustration, the term exceeds 5 years and the borrower is entitled to prepay. See *Deeth v. Standard Trust Co.* (1980), 12 R.P.R. 157 (Ont. Div. Ct.), and *Re Hodgson and Raskin* (1974), 4 O.R. (2d) 234, 47 D.L.R. (3d) 518 (H.C.J.).

[7] *Wertheim v. Chicoutimi Pulp Co.*, [1911] A.C. 301, at 307, [1908-10] All E.R. 707 (P.C.). Such damages are sometimes called "expectation damages": Fuller and Perdue, "The Reliance Interest in Damages" (1936), 46 Yale L.J. 52.

Despite the fact that a mortgage is a contract for the payment of a debt, contractual damage principles do not currently apply. Rather, existing law is based on the concept that the right of the lender to payment under the mortgage is essentially in the nature of a property right. By this analysis, a lender can be divested of such a property right only with his or her consent. And by requiring the borrower to obtain the approval of the lender, the lender is, in effect, granted the right to demand specific performance of the loan contract.[8]

As a matter of law and law reform, the decision to treat a particular relation as one protected by a property right, or as one governed by principles of contract law, should be made in order to further some social or other worthy value. For example, a purchaser of land has a claim to specific performance of the contract of purchase and sale because it is generally believed that land has unique qualities; accordingly, damages for breach of a contract to sell land would likely be inadequate compensation. In other words, it is thought that the claimant would be unjustifiably harmed by being denied the right to have the actual thing that was promised. The Supreme Court of Canada has emphasized, however, that specific performance should not be permitted in lieu of compensation by damages without some strong reason for doing so.[9]

(c) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

As we have discussed, the existing rule with respect to the right of prepayment appears to be based on the notion that the lender has a proprietary interest in the secured property that is sufficiently important to warrant specific performance of the loan agreement, rather than compensation for actual damages suffered. This rule is inconsistent with the view that equity has taken of the relationship between a borrower and a lender who takes land as security: equity recognized that the lender's real interest was in the debt due and not the land, which stands as mere security for that debt.[10]

Throughout this Report, we have proceeded on the premise that a security agreement is merely one type of contract. We can see no reason why, in the prepayment context, a lender should have the benefit of a rule based on the lender's acquisition of a property interest, rather than a rule based on ordinary contractual principles. Having regard to the test used by the courts in determining whether to grant specific performance of a contract,[11] we believe that, in most cases, there is no sense in which damages can be considered to be inadequate for the lender.

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[8] See the annotation to *Deeth v. Standard Trust Co.*, *supra*, note 6.

[9] *Asamera Oil Corp. Ltd. v. Sea Oil & General Corp.*, [1979] 1 S.C.R. 633, at 644-45, 89 D.L.R. (3d) 1, supplementary reasons given [1979] 1 S.C.R. 677, 97 D.L.R. (3d) 300 (*sub nom. Baud Corp., N.V. v. Brook*).

[10] See *supra*, ch. 2, sec. 1(a), and *infra*, ch. 8, sec. 2(a).

[11] *Asamera Oil Corp. Ltd. v. Sea Oil & General Corp.*, *supra*, note 9.

As the law now stands, a lender may exact from the borrower whatever penalty the lender chooses; or, by refusing to accept prepayment or to grant a discharge, the lender may require the borrower to fulfil the terms of the contract to the letter. As we have said, the penalty may be exacted even though the lender could relend the money immediately at a higher rate of interest, so that he or she would, in fact, benefit from the prepayment. This ability to penalize the borrower or to refuse to accept prepayment seems particularly unfair in the case of residential borrowers.

Nevertheless, we recognize that, with many commercial mortgages, a lender will very often be concerned with factors other than simply the payment of principal and interest under the terms of the security agreement. Innovative methods of financing may involve participation by the lender in the profits from a commercial activity on the secured property; in other cases, the lender may reap a financial benefit where the value of the land appreciates. Prepayment of mere principal and interest under such agreements could frustrate the lender's legitimate expectations. The alternative, which would require a quantification, in advance, of the value of the potential benefit that the lender would receive under the contract, may not be entirely feasible; indeed, in many instances, it would simply be impossible to calculate that benefit. In the case of commercial transactions, therefore, there is a stronger argument that the borrower should be held to the strict terms of the contract and that a right of prepayment should continue to be a matter for which the parties bargain.

It has been suggested to us that protected borrowers[12] should be given a statutory right of prepayment without any compensation to lenders. Many residential borrowers express strong resentment when the vagaries of the mortgage market lock them into a high interest rate mortgage at a time when interest rates have fallen dramatically. While this sentiment in favour of residential borrowers can be appreciated, the suggestion that there ought to be a statutory right of prepayment without compensation raises several important issues.

We have already emphasized our view that the rights and remedies of the parties to a security agreement should reflect, as far as possible, their essentially contractual relationship. A lender has an expectation of making a specified return for a particular period of time, and it is with that in mind that a lender enters into negotiations for a secured loan. This seems to us to be a legitimate expectation. There should be a very persuasive reason why a borrower should be permitted by law to breach the contract or, in effect, to alter its terms unilaterally. There seems to be no good reason why a borrower should have the benefit of a drop in the interest rate when a lender has no right to increase that rate if the market rate rises.

Leaving aside arguments of fairness to lenders, one must also bear in mind that the creation of a statutory right of prepayment, without compensation to lenders, would likely have substantial economic implications for all persons seeking a loan on the security of their land. The right of prepayment, as it currently exists in Ontario, is a privilege that is purchased by a borrower, in the same way as a favourable interest rate or a longer mortgage term. Legislation that confers such a right, without payment by borrowers, can be expected to have one of two results. Either the cost of that right would be passed on by lenders by means of increased interest rates that would be borne automatically by all borrowers, many or most of whom would derive no benefit from that added cost, or mortgage money would become less available to borrowers. Our perception of what is just and reasonable must take these likely consequences into consideration.

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[12] See *supra*, ch. 4.

(d) PROPOSALS FOR REFORM

The Commission is of the view that the issues concerning the right of prepayment cannot be resolved fairly by a single legislative regime applicable in all circumstances. In most instances, particularly in the case of residential property, the lender will be satisfied with repayment of the outstanding principal and interest, together with compensation for any actual loss incurred because of the prepayment. However, as we discussed above, commercial loan arrangements often involve other factors, so that there is a stronger argument to be made for a legal regime that permits the lender to hold the borrower to the strict terms of the agreement.

Accordingly, we recommend that the prepayment rights of a borrower who is not a protected borrower[13] should be governed by the terms of the security agreement. However, a borrower who is a protected borrower should be entitled to prepay the loan at any time, provided that the lender is fully compensated for the actual loss incurred as a result of the prepayment. Full compensation to the lender should include not only compensation for loss of interest where the interest rate at the date of prepayment has fallen (''prepayment compensation''), but also the transaction costs involved in making a new loan.[14]

To avoid any uncertainty concerning the quantum of compensation payable, we further recommend that the new *Land Security Act* proposed by the Commission should provide a formula for determining the value of prepayment compensation to the lender.[15] The compensation should represent the present value of the difference between the amount the lender would have earned under the security agreement, and the amount that, at current market rates of interest (the ''current interest rate''),[16] the lender would now earn in a substitute investment. For example, assume that, on January 1, 1985, $100,000 was lent under the security agreement for two years, at 15%, payable annually, not in advance, and that the borrower wished to prepay one year later, on January 1, 1986, when the interest rate on the lender's potential substitute investment had fallen to 12%. On the assumptions that have been made,[17] the amount to be paid to the lender as compensation for the prepayment would be calculated as follows:

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[13] *Ibid.*

[14] See the draft *Land Security Act* proposed by the Commission, *infra*, Appendix 1 (hereinafter referred to as ''draft Act''), s. 5.4(3).

[15] *Ibid.*, s. 5.4(4).

[16] *Ibid.*, s. 5.4(1)3. A substitute investment is an investment roughly comparable to one for the remaining term of the original security agreement. It is assumed that, consistent with the principle of mitigation, the lender will make a substitute investment.

1.	Interest that would have accrued from January 1, 1986, to January 1, 1987	$ 15,000
2.	Interest that would accrue from January 1, 1986, to January 1, 1987, if loan repaid on January 1, 1986, and lender reinvests $100,000 at 12%	$ 12,000
3.	Difference between interest that would have been earned (1) and interest that would now be earned (2)	$ 3,000
4.	Present value, at January 1, 1986, of $3,000, due on January 1, 1987, at 12% (the "prepayment compensation")	$2,678.57

Under our recommendations, the borrower could prepay by paying the principal, $100,000, and accrued interest from January 1, 1985, to January 1, 1986, of $15,000 ($100,000 x 15%), plus prepayment compensation of $2,678.57, for a total of $117,678.57. Of this amount, $102,678.57 represents principal that, if reinvested by the lender on January 1, 1986, at the current rate of 12%, would bring in $15,000 on January 1, 1987. Leaving aside the $15,000 earned interest to January 1, 1986, this return is exactly what the lender would have received on January 1, 1987, had the loan been repaid in accordance with its terms.

We recommend further that the *Land Security Act* should specify how the "current interest rate" should be calculated for the purpose of the formula used to determine the appropriate prepayment compensation. Ordinarily, the rate should be the current rate for the lender's potential substitute investment.[18] There are fairly standardized or "going" rates for various kinds of residential security agreement with institutional lenders. Therefore, usually it should be a simple matter to determine the appropriate current interest rate for the purpose of prepayment.

Alternatively, the parties should be entitled to provide in the security agreement that, for the purpose of prepayment, the current interest rate shall be calculated with reference to a lender that is in the business of making loans secured by security agreements similar to the borrower's security agreement.[19] For example, a borrower and a non-professional lender could agree to use the current rate charged by a particular chartered bank.

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[17] We are also assuming that the mortgage provides for the payment of interest only. For any other payment terms, the calculations are the same in principle, although more complex in detail. In addition, we are ignoring transaction costs and any compounding of interest payments. Finally, we are assuming that the interest payments are to be made in equal yearly instalments of $15,000.

[18] Draft Act, s. 5.4(1)3(i).

There may be slightly more difficulty in arriving at an appropriate current interest rate where a lender does not have an easily determined "going rate", or has not agreed in advance to use the rate of another specified lender, for the type of security agreement being prepaid. This may be the case where the lender is, for example, an individual or corporation that makes only occasional loans. We have been advised that it is, nevertheless, possible to establish a market rate for comparable security agreements, which is known to the lending industry, usually through published figures. We recommend that if the lender does not have a current rate for a potential substitute investment at the time of prepayment, the market rate should be used.[20]

The previous example used by the Commission to illustrate how the basic formula for prepayment compensation would work was, as we indicated, a simple one, taking into account only the loss of interest where the rate falls. But interest is not the only loss that a lender can incur upon prepayment. There are also the transaction costs involved in making a new loan, which include both administrative costs and the interest lost during the time it takes to relend the amount repaid. As we have said, the lender's right not to be financially prejudiced by any prepayment necessitates a recovery of these amounts. Accordingly, the Commission recommended that, in addition to prepayment compensation, a lender should be entitled to compensation for the transaction costs incurred in relending the money. The amount of compensation should be the lesser of one month's interest or an amount prescribed by regulation.[21]

Any dispute regarding the amount due under the security agreement or the amount of compensation to which the lender is entitled should be resolved by an application to the court.[22]

We now turn to consider the method of exercising the protected borrower's right of prepayment. The borrower should be entitled, by notice, to require from the lender a statement of account, in prescribed form, as recommended below.[23] The borrower's notice requesting a statement should specify that the statement of account is for the purpose of prepayment and should be served on the lender in the manner proposed later in this Report.[24]

The borrower's request for a statement of account should also specify the date upon which the statement is to be effective. For reasons that will be discussed below, the effective date specified by the borrower should be a date not more than thirty days after the date of the notice.[25]

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[19] *Ibid.*, s. 5.4(1)3(ii).

[20] *Ibid.*, s. 5.4(1)3(iii).

[21] *Ibid.*, s. 5.4(3).

[22] *Ibid.*, s. 5.4(6).

[23] *Ibid.*, s. 5.4(5). See, generally, *infra*, this ch., sec. 3.

[24] Draft Act, s. 3.15(3)(a) and (b). See, also, *infra*, ch. 11, sec. 2.

The prepayment statement of account should be provided within fifteen business days after the date on which service of the notice from the borrower requesting the statement of account is effective.[26] If the lender fails to provide the statement as required, the borrower should be entitled to have recourse to the procedure recommended below with respect to obtaining a discharge.[27]

In addition to the information that we shall propose should be contained in a conventional statement of account, for the purpose of prepayment the statement should also show the prepayment compensation and the transaction costs required to be paid, as well as the method by which such amounts were calculated.[28]

Interest rates can vary from month to month; occasionally, the variation in the rate can be significant. In order to ensure the lender receives prepayment compensation based on the most current interest rate, the lender should not be required to provide a statement of account more than thirty days prior to the effective date specified by the borrower in the request for the statement. Accordingly, we have recommended that the effective date specified in the borrower's notice requesting the statement of account should be a date not more than thirty days after the date of the notice.[29]

We further recommend that prepayment should not merely suspend the running of interest, as is now the case under section 17 of the *Mortgages Act*[30] and section 10 of the *Interest Act*.[31] Rather, upon being paid or tendered the outstanding principal and compensation, in the amount determined, the lender should be required to give the borrower a discharge in registrable form at no cost to the borrower.[32]

Insofar as section 16 of the *Mortgages Act* is concerned, we understand that, in the past, when interest rates were fluctuating dramatically, borrowers who had mortgages at unfavourable interest rates would sometimes attempt to use the section as a *de facto* prepayment provision: such borrowers would let the loan go into default and then pay the three months' interest in addition to the principal amount outstanding and costs. We are of the view that section 16 is inconsistent with the general intent of the prepayment proposals, since it effectively allows any borrower to prepay upon default with a prepayment penalty of three months' interest.

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[25] Draft Act, s. 3.15(3)(c).

[26] *Ibid.*, s. 3.15(5), incorporated by reference under s. 5.4(5).

[27] See *infra*, this ch., sec. 2(b).

[28] Draft Act, s. 5.4(5), incorporating, through s. 3.15(1), s. 3.16(2)(j).

[29] *Ibid.*, s. 3.15(3)(c).

[30] *Supra*, note 2.

[31] *Supra*, note 3.

[32] Draft Act, s. 3.17(1). With respect to discharges, see *infra*, this ch., sec. 2.

Accordingly, we recommend that sections 16 and 17 of the *Mortgages Act* should be repealed and that the Parliament of Canada should be requested to amend section 10 of the *Interest Act* so that it does not apply to Ontario.

2. THE BORROWER'S RIGHT TO OBTAIN A DISCHARGE

(a) Present Law

Where the borrower has repaid the loan and has performed all of the obligations to the lender, the borrower is entitled to have the mortgage discharged. Ordinarily, the borrower simply requests a discharge from the lender and the lender prepares the discharge and delivers it to the borrower in a timely fashion. The borrower is responsible for registering the discharge in the appropriate land registry office.

Although preparation of a discharge is fairly simple, we are advised that the fee charged for such preparation can vary widely from lender to lender. A borrower has little choice but to pay the lender's stated fee when a discharge is required.

In the event that the lender is either unwilling or unable to prepare a discharge of the mortgage, the borrower may seek a judicial discharge by making an application to the court under section 11 of the *Mortgages Act*.[33] In cases where the lender cannot be found, or is dead, or where for any other cause a proper discharge cannot be obtained, or cannot be obtained without undue delay, section 11(3) empowers the court to permit payment into court of the amount due on the mortgage and to make an order discharging the mortgage. Where the lender is evading or ignoring the borrower's request for a discharge, the court is entitled to rely on the borrower's evidence of payment of the debt or of the amount due. If the precise amount presented by the borrower for payment is in question, the court has a discretion under section 11(6) and (7) to require payment of additional amounts that may be owing to the lender, including subsequent costs and interest.

(b) Proposals for Reform

The lender currently has the responsibility for preparing the discharge, while the borrower must arrange for its registration. The Commission has considered a suggestion that the lender should be obliged not only to prepare, but also to register, the discharge upon satisfaction of the loan obligation by the borrower. This suggestion arises from a concern that many borrowers are unaware of the nature and significance of the discharge and, therefore, may neglect to register it, thereby increasing the chances that the discharge will be lost or mislaid.

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[33] *Supra*, note 2.

Lenders, however, object to the imposition of the responsibility for registering the discharge. They argue that compliance with such a requirement could be both difficult and expensive. The cost to which they refer is not the registration fee, which is minimal; rather, lenders object to the administrative costs, as well as the inconvenience, involved in registration, which may be quite substantial where the property lies in a remote area. Lenders also point out that many borrowers want the discharges approved by their own solicitors prior to registration, thereby adding to the lender's inconvenience and expense.

As for the concern regarding loss of the discharge document, it seems clear that institutional lenders generally cooperate in providing a duplicate certificate of discharge in the event that the original is misplaced. The real difficulty with the suggestion that lenders should both prepare and register the discharge arises with respect to non-professional lenders, rather than institutional lenders. It is the non-professional lender who may be ignorant of any statutory requirement for registration of the discharge.

In the Commission's view, the desired balance between the interests of the borrower and those of the lender would be best achieved by the following recommendations. As soon as the obligation whose performance is secured by the security agreement is performed, or the borrower is otherwise entitled to a discharge, the lender should be required to prepare a discharge of the security agreement in registrable form, as well as a release of insurance and discharge of any collateral security, in registrable form, without charge to the borrower. The lender should serve the discharge and other documents on the borrower within ten business days of the date on which the borrower is entitled to the discharge.[34]

We believe that lenders could easily devise a system alerting them to the need for a discharge. Furthermore, automatic preparation and delivery of a discharge upon entitlement could prevent future problems: for example, if the requirement to prepare a discharge is operative only where the borrower makes a request, the lender may no longer be in business at the time when the borrower actually needs, and requests, a discharge.

We do recommend, however, that the borrower should continue to have the responsibility of registering the discharge. In order to minimize the possibility that the discharge will be lost or mislaid, the discharge should be accompanied by a notice stating clearly that the discharge should be registered in the appropriate land registry office, and setting out the address of that office.[35]

In the event that a lender fails, without reasonable excuse, to comply with the proposed obligation to prepare and deliver a discharge of the security agreement and any release of insurance and discharges of collateral security within the stipulated time, the lender should be liable for any loss or damage caused thereby.[36] In addition, we believe that a borrower should have access to an expeditious and inexpensive mechanism for obtaining the discharge.[37]

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[34] Draft Act, s. 3.17(1) and (2).

[35] *Ibid.*, s. 3.17(2).

Accordingly, we recommend that, where the lender fails, without reasonable excuse, to prepare and deliver the discharge and other documents, as proposed above, the borrower should be entitled to serve on the lender a written request for the discharge. The lender should be required to deliver the discharge and other documents to the borrower within ten days after receipt of this request.[38] If the lender fails to make such delivery, the borrower should be entitled to apply to the court for relief. Where the court is satisfied that all money due under the agreement has been paid and all covenants have been performed, the court should have the power either to order the lender to provide a discharge of the security agreement in registrable form, a release of insurance, and a discharge of any collateral security in registrable form,[39] or to make an order discharging the security agreement, releasing any insurance, and discharging any collateral security.[40]

The preceding recommendations would facilitate the obtaining of a discharge directly from the lender or from the court itself where the borrower has paid the loan in full and is entitled to a discharge, but has been unable to obtain one from the lender. However, in some cases, the borrower's problem may not be simply the lender's failure to comply with the borrower's request for a discharge. Rather, the borrower may wish, for example, to prepay the loan and obtain a discharge, but may be unsuccessful in obtaining a statement of account from the lender in order to do so. Or a borrower who is entitled to pay off the security agreement may tender the amount outstanding, but the lender may refuse to accept it.

The Commission is of the view that the borrower or any other person entitled to pay off the loan should have access to the court to obtain relief under these circumstances. While, in the section that follows, we shall make recommendations concerning the borrower's remedy where the lender has not served a statement of account on a person requesting it,[41] the proposed remedy is restricted to the provision of a statement of account alone; it does not deal with the borrower's further need for a discharge. Where a statement of account, as well as a discharge, is required, we see no justification for two possible court applications, one to obtain the statement of account and another to obtain the discharge.

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[36] *Ibid.*, s. 3.17(3).

[37] The Commission considered, and rejected, a suggestion that a discharge should automatically issue from the appropriate land registry office where the lender has failed to deliver the discharge to the borrower within the stipulated time. While the convenience of this mechanism is attractive from a borrower's point of view, it would require complex administrative control and monitoring. The land registry office would be required to assume expanded responsibilities with respect to a discharge, such as ensuring that it was accompanied by the relevant affidavit, specifying, for example, the amount owing to the lender and the basis for arriving at this amount.

[38] Draft Act, s. 3.17(4).

[39] *Ibid.*, s. 3.17(4)(a).

[40] *Ibid.*, s. 3.17(4)(b). See, now, s. 11 of the *Mortgages Act*, *supra*, note 2, and *supra*, this ch., sec. 2(a), concerning s. 11.

Accordingly, we recommend here that, when a borrower or any person entitled to pay off a security agreement desires to do so and the lender cannot be found, or where from any other cause a proper discharge cannot be obtained, or cannot be obtained without undue delay and expense, on the application of the borrower or the person entitled to pay off the security agreement, the court should be empowered to direct payment into court of the amount due under the security agreement and to make an order discharging that agreement, releasing any insurance on the property, and discharging any collateral security. The money paid into court should be paid out to the lender or as the court may direct. In addition, the court should be empowered to require notice to be given to the lender or those claiming under the lender, either before or after making the order, by advertisement or in any other manner as is considered proper.[42]

Where a borrower seeking a discharge applies to the court for relief, or where the lender or another party either receives a notice of, or is otherwise alerted to, the payment into court, as described above, the lender or other party may intervene in the court application. We recommend that, where an issue arises as to who is entitled to receive payment or as to the reasonableness or amount of the payment,[43] the court should be empowered, as a condition of making an order, to require payment into court of a sum in excess of the amount admitted to be due and to answer any claim by the lender for subsequent interest and costs. The sum paid into court should be subject to the further order of the court, and the court should be empowered to require payment into court of an additional sum.[44]

Finally, the Commission recommends that where the court makes an order discharging the security agreement, releasing any insurance, and discharging any collateral security, the borrower should be entitled to register the order in the proper land registry office, and the registered order should be conclusive of the matters determined in the order and should have the same effect as the registration of a certificate of discharge signed by the lender.[45]

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[41] See *infra*, this ch., sec. 3(d)(iii), and draft Act, s. 3.15(6).

[42] *Ibid.*, s. 3.17(5)(c).

[43] Under *ibid.*, s. 6.13(3).

[44] *Ibid.*, s. 3.17(6).

[45] *Ibid.*, s. 3.17(7).

3. THE BORROWER'S RIGHT TO A STATEMENT OF ACCOUNT

(a) PRESENT LAW

Many lenders automatically provide to borrowers an annual statement of account and make every effort to provide, on request, a fully detailed statement of account for use in sale and refinancing transactions. The statement usually includes an indication of the amount of principal and interest paid by the borrower in the preceding year, and the amount that remains outstanding on the loan. Where realty taxes are paid by the lender, the statement ordinarily indicates the taxes paid in the last year and the amount, if any, in the tax account.

The provision of such statements of account is either a contractual right of the borrower or a discretionary service provided by the lender. With one statutory exception, it is not a right automatically enjoyed by every borrower, regardless of how pressing the need for such statements may be.

A borrower currently has a statutory right to obtain a statement of account where he or she is in default under the security agreement. Section 21(1) of the *Mortgages Act*[46] grants relief to a defaulting borrower where, by reason of the default, the whole principal and interest becomes due and payable, so long as the borrower remedies the default before a sale of the property, or before the commencement of an action by the lender or any person claiming through or under the lender. The right to redeem provided in section 21(1) is exercisable by the borrower notwithstanding any agreement to the contrary.

Section 21(2) of the *Mortgages Act* provides that a borrower may, by a notice in writing, require the lender to furnish him or her with a written statement indicating the "amount of the principal or interest with respect to which the mortgagor is in default", or "the nature of the default or the non-observance of the covenant", as well as the "amount of any expenses necessarily incurred" by the lender. If the lender fails to answer the request for a statement within fifteen days after the request is received, or if the statement is incomplete or incorrect, section 21(3) provides that, unless the lender has a reasonable excuse, the lender's rights to enforce the mortgage are suspended until there has been compliance with the section.

As we have said, even this limited right to obtain a statement under section 21 exists only until a sale under the mortgage or until an action has been commenced to enforce the rights of the lender or of any person claiming through or under the lender. After a sale or the institution of an action, the relief provisions of section 22 govern, and there is no analogous right to obtain a statement of account under section 22. If an action has been commenced by the lender in respect of the borrower's default, and if the pleadings simply claim a specified total amount owing under the mortgage, without more detail, the borrower may have some difficulty in establishing the state of accounts.

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[46] *Supra*, note 2.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

A statement setting out details of the loan account may be needed, or simply wanted, by a borrower for a variety of reasons. A statement of account may be requested to satisfy the borrower's curiosity, to update records, to facilitate shopping for a new loan, or to check the accuracy of the lender's records. There are also circumstances, such as a sale of the property, where a borrower needs a statement whose accuracy and completeness can be relied upon.

As we have indicated, aside from a contractual right or the limited right under section 21 of the *Mortgages Act*, a borrower cannot require a lender to supply a statement of account. Yet, because of advances in contemporary technology, the provision of a statement of account by the lender is no longer an onerous burden. Computerized records and amortization and payment tables have replaced hand-written ledgers and records of payments. Even a private lender, or a professional acting for him or her, can obtain the necessary information for a modest fee.

At the same time, contemporary market trends and interest rates have had the effect of increasing the borrower's need for a statement of account. Five percent and six percent interest rates and long term mortgages have been replaced by interest rates that fluctuate between ten and fifteen percent, resulting in an increase in short term and variable rate loans. The competition in the residential mortgage market has greatly increased, with the result that borrowers are no longer as inclined, as they once were, to stay with one lender for the entire period for which financing for the property is required.

For all these reasons, borrowers require, more often than before, detailed and updated statements of account. We believe that the law does not adequately facilitate this legitimate wish.

(c) THE LAW IN OTHER JURISDICTIONS

(i) Manitoba

Section 25 of the *Mortgage Act*[47] provides that a borrower is entitled to obtain a statement of account by making a written request to the lender. Under section 25(2), the statement must be in writing and must set out:

> (a) the amount of payments credited, including apportionment as between principal, interest, and, if applicable, taxes;
>
> (b) the amount of any payments made by the mortgagee and charged to the mortgagor's account, indicating the nature of the payments;

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[47] R.S.M. 1970, c. M200, as am. by S.M. 1972, c. 28, s. 1. This legislation implements the recommendations made in Manitoba Law Reform Commission, Report No. 5, *Report on Recommended Right of Mortgagors to Obtain Annual Statements*, in Manitoba Law Reform Commission, *Reports and Recommendations* (1971) 20.

(c) the amount of the outstanding balance owing on the mortgage debt as of a date not more than thirty days prior to the date he receives the written request;

(d) the date of the last credited payment received within the period covered by the statement; and

(e) the status of the tax account, where tax instalments have been paid to the mortgagee and credited separately for tax purposes.

A borrower is entitled to receive a statement of account, without cost, once in every twelve month period.[48] Moreover, where a statement of account is required in order to pay the mortgage debt or in connection with the sale of the mortgaged property, the borrower may request the statement to be furnished before the expiration of the twelve month period.[49] However, in such a case, the statement is required to cover only a twelve month period or the period of time that has elapsed since any previous statement was furnished under the section, whichever is the shorter period. This statement is also available without cost to the borrower.

A lender who fails to comply with the request of the borrower for a statement is liable to pay the reasonable costs incurred by the borrower in obtaining elsewhere a computed statement of account of the mortgage debt.[50] Such costs are credited to the borrower as against the mortgage debt, and the amount of those costs are conclusively deemed to have been a payment in reduction of the principal balance outstanding. The Act requires every mortgage instrument to contain a notice of the right to obtain a mortgage statement; the notice must be printed or stamped in bold face characters or in variant coloured ink.[51]

(ii) United States

Section 3-209 of the American Uniform Land Transactions Act[52] provides that a borrower may request, in writing, a statement of account as of a specified date. The lender must comply within two weeks after receipt of the written request by sending a statement of account that indicates the principal amount due, the accrued interest, any other sums outstanding, and the applicable interest rate. The statement must also indicate the status of any escrow account, for such expenses as taxes or insurance, that is being held by the lender in connection with the loan. A lender who, without reasonable excuse, fails to comply with a written request is liable for any damage caused to the borrower by such failure.

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[48] *Mortgage Act*, *supra*, note 47, s. 25(3).

[49] *Ibid.*, s. 25(4).

[50] *Ibid.*, s. 25(5).

[51] *Ibid.*, s. 25(6).

[52] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

The Comment to section 3-209 explains that the purpose of this section is to reduce what in effect is the power of a lender to prevent the borrower from disposing of the collateral by the lender's withholding of essential information. It points out that if, for example, the borrower wishes to sell for "cash", there are calculations at closing that must be made, such as the amount of unpaid principal and the interest that has accrued since the last payment by the borrower to the lender. Section 3-209 requires a lender to make a statement to the borrower of the amount outstanding on the loan. The Comment emphasizes that, as a result of technological improvements in electronic record keeping, the burden of providing such a statement is not a heavy one.

Section 3-209 provides that a borrower is entitled, on request, to receive a free statement once every six months. The lender is required to furnish statements on request more frequently than this, but the lender is entitled to charge a fee, not exceeding ten dollars, for these additional statements. If a lender provides a statement automatically and periodically without a request by the borrower, and the statement contains the information specified above, the lender may also impose a charge, not exceeding ten dollars, for any further statement that is requested within twenty-one days before or after the date of the unsolicited statement. The Comment explains that, while the section gives the borrower the right to obtain a certain number of statements, without charge, notwithstanding any agreement to the contrary, it is also intended to control the possibility of harassment of the lender by limiting the number of times the debtor can obtain a free statement.

Section 3-209(d) specifies the lender's liability for the information contained in the statement. It provides that any statement of account provided under this section that is relied upon by a purchaser or other interested party, in good faith and to his or her detriment, is binding on the lender with respect to that person.

(d) PROPOSALS FOR REFORM

(i) Statements of Account

There are many valid reasons why a borrower may request a statement of account from the lender. As we have discussed, the provision of such statements by lenders is not burdensome, in light of contemporary technology, and many lenders now automatically provide at least an annual statement of account.

With respect to the method by which a borrower may exercise the right to obtain a statement of account, reference should be made to the discussion of this matter in the narrower context of statements of account required for the purpose of prepayment.[53] The Commission is of the view that these earlier proposals are equally appropriate in the larger context and should be adopted generally.

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[53] See *supra*, this ch., sec. 1(d).

Accordingly, we recommend here that a borrower and any subsequent encumbrancer who has the right to remedy the borrower's default[54] should be entitled, by a notice in writing, to require a lender to provide a statement of account at any time.[55] The notice should be served on the lender in the manner proposed later in this Report,[56] state that the statement of account is required for the purpose of prepayment,[57] if such is the case, state the date upon which the statement of account is to be effective, which should be a date not more than thirty days after the date of the notice, and enclose the prescribed fee.[58] The lender should be required to serve the statement of account on the person serving the notice within fifteen business days after the date on which service of the notice is effective.[59]

The borrower should be entitled to receive one free statement of account within every twelve month period after the date of the execution of the security agreement.[60] For example, if the security agreement is executed on December 1, 1986, the borrower should be entitled to receive one free statement at any time in the period up to November 30, 1987, another free statement at any time up to November 30, 1988, and so on. Subsequent encumbrancers, however, should be required to pay the prescribed fee in all cases.

There will be occasions where a borrower will need more than one statement of account within the proposed twelve month period. We recognize that, although it is now relatively easy and inexpensive for a lender to produce a statement of account, costs are nevertheless involved in such preparation. In order to discourage repeated, unnecessary requests for statements, and to defray the costs incurred by the lender in the production of additional statements, we recommend that, where a borrower requests additional statements within the twelve month period, he or she should be required to pay, in advance, the lender's reasonable costs of producing each additional statement. A maximum charge for such a statement should be established by regulation.[61] We recommend that the initial maximum amount should be $25.

While the proposed statement of account need not be in any particular form, it should be in writing and should set out, in plain language, the following information:[62]

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[54] Draft Act, s. 6.9.

[55] *Ibid.*, s. 3.15(1).

[56] *Ibid.*, s. 3.15(3)(a), and *infra*, ch. 11, sec. 2.

[57] Draft Act, s. 5.4.

[58] *Ibid.*, s. 3.15(3).

[59] *Ibid.*, s. 3.15(5).

[60] *Ibid.*, s. 3.15(4).

[61] *Ibid.*, s. 3.15(1) and (3)(d).

[62] *Ibid.*, s. 3.16(2). With respect to the "plain language" requirement, see, also, *infra*, ch. 7, sec. 3(c).

1. the principal amount due at the beginning of the period;[63]
2. the amount of payments credited during the period;
3. the apportionment of payments credited during the period on account of principal, interest, and taxes, or any other matters;
4. the amount of any payments made by the lender and charged to the security agreement during the period and indicating the nature of the payments;
5. the status of the tax or any other accounts maintained by the lender in respect of the security agreement at the end of the period;
6. the principal amount due at the end of the period and the method by which the amount was calculated;[64]
7. the interest rate or rates charged on the security agreement during the period, including the rate on the date of the statement of account;
8. the amount of any charge assessed against the borrower arising out of the borrower's default, if any, and the nature of the charge;
9. the amount, if any, required to be paid to bring the security agreement into good standing;
10. if the statement of account is required for the purpose of prepaying the security agreement, the compensation required to be paid and the method by which the compensation was calculated;
11. if the effective date specified in the request for a statement of account requires the lender to assume that certain payments will be made before the effective date, a statement that it is correct only if such payments are duly made; and
12. such other information as may be prescribed.

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[63] Draft Act, s. 3.16(1) defines "period" to mean:

> (a) the period between the date the last amount on account of principal was advanced to the borrower under the security agreement and the date of the statement of account, if no statement of account has been previously provided to the borrower; or
>
> (b) the period between the date of the statement of account most recently provided to the borrower and the date of the statement of account.

[64] We recognize that there may be difficulties in the case of price level adjustment loans and shared appreciation loans (see *supra*, ch. 3, notes 21 and 22, respectively) with respect to the calculation of the new principal, as the amount outstanding may not be ascertainable except by a determination of the factors specified in the loan agreement. For example, in the case of a shared appreciation loan, ordinarily a new appraisal of the secured property is necessary in order to establish the present value of that property.

The obligation to provide a statement of account upon request should apply to all lenders. Non-institutional lenders who do not have ready access to computer or other electronic record keeping equipment can arrange to have the statement prepared by one of the many professional services that produce payment and amortization schedules.

The statement of account should be effective as of the date specified in the notice requesting the statement.[65] The statement of account should bind the lender in favour of the person requesting the statement and any person to whom the lender might reasonably expect such person to provide the statement, if the statement is reasonably relied upon to the recipient's detriment.[66]

We have previously recommended that, where the borrower or subsequent encumbrancer requests in writing a statement of account as of some specified future date, such as the closing date in a sale of the property, the lender should be required to state expressly any facts that, in the intervening time period, may affect the outstanding amount or any other matter dealt with in the statement, such as the borrower's need to make timely loan or tax payments.[67] We have concluded that, aside from this type of proviso, a lender should not be entitled to qualify the statement of account, or obtain a waiver of liability through the use of a disclaimer or an "errors and omissions excepted" clause, where the statement of account has been provided by the lender after a written request has been made by the borrower or subsequent encumbrancer.[68]

As indicated above, we recognize that it is the current practice of many lenders to send an informal, annual statement automatically to all borrowers. The proposals made above reflect our view that the right of the borrower to a statement with information that is accurate and current should not be dependent upon the lender's discretion and convenience. Nevertheless, in order not to discourage the useful practice of providing an informal, unsolicited statement for the borrower's information, we recommend that a lender should be entitled to include an "errors and omissions excepted" clause on such a statement, provided that the statement also clearly indicates that it is an informal, non-binding statement only and that a borrower who wishes to rely on the completeness and accuracy of a statement must make a written request to the lender for a formal statement of account that, as we have recommended, will bind the lender.[69]

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[65] Draft Act, s. 3.16(3). It will be recalled that, under an earlier proposal, the notice requiring the lender to deliver a statement of account must state an effective date not more than 30 days after the date of the notice: see *supra*, this ch., sec. 3(d)(i), and draft Act, s. 3.15(3)(c).

[66] *Ibid.*, s. 3.16(4).

[67] *Ibid.*, s. 3.16(2)(k).

[68] *Ibid.*, ss. 3.16(4) and 2.5 (the general non-waiver provision).

[69] *Ibid.*, s. 3.16(9).

(ii) Amendment of a Statement of Account

Errors will occasionally arise in a statement of account. Given the fact that a statement requested by the borrower or subsequent encumbrancer will bind the lender in certain circumstances, a mechanism for amending an incorrect statement, and thereby removing a potential source of liability, should be established. Accordingly, the Commission recommends that, except where a statement of account is issued by the court under recommendations to be made in the following section, a lender should be entitled to notify a person who has received a statement that an error has been made, and to provide that person with an amended statement of account.[70] However, the lender should remain liable for any loss that has been suffered as a result of reasonable reliance on the original statement, as proposed above.[71] Clearly, reliance would not be reasonable if, for example, the original statement was actually known to be wrong by the party seeking to hold the lender liable.

The person requesting the statement is, of course, not the only person who has a direct interest in obtaining an amended statement. For example, a borrower may have given the incorrect statement to a third party, who may have acted in reasonable reliance on the statement. Reliance by third parties will generally be an issue only where there is to be a sale of the property, or where a statement is provided to creditors of the borrower for use in determining the latter's equity in the secured property or his or her general creditworthiness. We have already recommended that a lender should be liable to third parties to whom the lender might reasonably expect the borrower to provide the statement and who have acted to their detriment in reasonable reliance on it. We further recommend that the onus should be on the lender to determine from the person requesting the statement whether the incorrect statement has been given to a third party and to deliver to that party an amended statement. Until the lender does so, the lender's potential liability to the third party should continue.[72]

The burden of determining the persons to whom an incorrect statement has been given will not be onerous. If the statement is to be used in a sale where the purchaser is to assume the obligations under the existing security agreement,[73] the lender will generally have been alerted to the fact of a sale by the borrower's request for a statement as of a specified closing date. In such a case, the lender can inquire of the borrower who the purchaser is and take steps to ensure that that person has received a corrected statement. If the lender fails to make such inquiries, it seems fair that the lender should be bound by the error.

The burden on the lender will be greater in other cases. For example, the lender will be less aware of a creditor of the borrower who intends to rely on the incorrect statement in determining the borrower's equity in the property or the borrower's general creditworthiness. Accordingly, to be prudent, a lender should inquire of the borrower as to any person to whom the statement has been given, and take the necessary steps to provide a corrected statement to that person. Again, we do not believe that this imposes an unwarranted or particularly onerous burden on the lender. To facilitate the transmittal of information to the lender, we recommend that, at the lender's request, any person who has received a statement of account should be required to provide forthwith to the lender the names and addresses of those persons who he or she knows or ought to know have received a copy of a statement.[74]

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[70] *Ibid.*, s. 3.16(5).

[71] *Ibid.*

[72] *Ibid.*, s. 3.16(4) and (5).

[73] If the statement is merely being used for a payout of the loan by the borrower, the third party purchaser would be unaffected by the error.

In some cases, the person who has received a statement of account may fail to comply with the preceding obligation or may be negligent in providing the requisite information. Under these circumstances, we do not believe that it would be equitable to impose liability on the unsuspecting lender. While the lender's error has been the initial cause of the problem, he or she should not be made to pay, at least ultimately, for the failure to fulfil the proposed requirements. Accordingly, in such a situation, while the lender should remain liable directly to a third party who has suffered a loss after reasonably relying on the incorrect statement, the lender should be able to seek indemnification from the person from whom the information has been requested for any damages paid by the lender to that party.[75]

We consider it unnecessary to establish a time limit within which the lender must notify the borrower or third party of the error. The lender's incentive to provide an amended statement immediately on discovery of the error will lie in the fact that the longer the borrower or third party remains unaware of the error, the greater the chance of detrimental reliance, with resulting liability in the lender for any damages that ensue.

(iii) Applications to the Court: Non-Compliance by Lender and Disputed Statements

If the lender fails to produce a binding statement of account within the proposed fifteen day period,[76] the borrower should be entitled to apply to the court to obtain the statement. The court should be empowered either to order the lender to prepare and issue the statement of account or to prepare and issue the statement itself.[77] Upon such application, the borrower would be required to present such evidence of payment as is satisfactory to the court.

In some instances, a dispute may arise regarding the accuracy or sufficiency of the proposed statement of account. We recommend that such a dispute should be resolved by application to the court by any interested person.[78]

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[74] Draft Act, s. 3.16(6).

[75] *Ibid.*, s. 3.16(7).

[76] See *supra*, this ch., sec. 3(d)(i).

[77] Draft Act, s. 3.15(6).

[78] *Ibid.*, s. 3.16(8).

(iv) Effect of Non-Compliance

We have concluded that, although the lender's failure to deliver a statement of account, as required, should not affect his or her substantive rights under the security agreement, a lender who fails, without reasonable excuse, to deliver the required statement should be liable, on the application of the person requesting the statement, for any loss or damage caused to the applicant.[79] Moreover, failure to comply, without reasonable excuse, should be an offence punishable by a fine of not more than $2,000.[80]

4. DUE-ON-SALE, DUE-ON-ENCUMBRANCE, AND DUE-ON-NEGOTIATION CLAUSES

(a) DUE-ON-SALE CLAUSES

(i) Present Law

A due-on-sale clause, also called an optional maturity clause, gives a lender the contractual right to call the loan if the borrower sells the secured property, thereby preventing any assignment of the mortgage by the borrower to the purchaser. Occasionally, arguments have been made that such clauses are invalid because they constitute an impermissible restriction on the alienation of land. However, such arguments have generally been rejected by the courts,[81] and there is nothing in the law of Ontario that limits the operation of due-on-sale clauses.

(ii) Deficiencies in the Law and the Case for Reform

A due-on-sale clause serves two functions for the lender. First, it provides a lender who has given a loan at a fixed rate of interest with an opportunity to benefit from a rise in interest rates during the term: if the borrower sells the property, the lender can call the loan and relend the money at the higher rate. Secondly, a due-on-sale clause allows the lender to control the risk that the purchaser of the property, who may otherwise take an assignment of the existing security agreement, will not be creditworthy.

It is clear that due-on-sale clauses offer a significant advantage to lenders. However, it is not apparent that this advantage is generally recognized by borrowers. We are advised, for example, that most borrowers who agree to a due-on-sale clause do not attempt to negotiate any concession on the interest rate charged. There is a general sense that a borrower's lack of awareness of the significance of such a clause creates an unfair advantage in favour of the lender and can often result in surprise to a borrower when he or she discovers, usually after execution of an agreement of purchase and sale, that the loan may be called on the sale of the property.

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[79] *Ibid.*, s. 3.15(7).

[80] *Ibid.*, s. 3.15(8).

[81] *Weeks v. Rosocha* (1982), 36 O.R. (2d) 379 (Co. Ct.), rev'd on other grounds (1983), 41 O.R. (2d) 787 (C.A.); *Briar Building Holdings Ltd. v. Bow West Holdings Ltd.* (1981), 16 Alta. L.R. (2d) 42, 126 D.L.R. (3d) 566 (Q.B.); and *Canada Permanent Trust Co. v. King's Bridge Apartment, Ltd.* (1984), 48 Nfld. & P.E.I.R. 345, 8 D.L.R. (4th) 152 (Nfld. C.A.).

The central policy issue with respect to due-on-sale clauses is the question of who should be entitled to obtain the benefit of a rise in interest rates during the term of the agreement. It has been suggested that, as a matter of social policy, it is preferable that borrowers, rather than lenders, should obtain the benefit of a rise in interest rates.[82] Where interest rates have increased, a borrower ordinarily will want to offer to the purchaser the valuable lower interest rate for the balance of the term of the agreement as part of the sale package, since the property obviously will be more attractive if the purchaser can finance the purchase at that lower rate. In selling the lower interest rate to the purchaser, the borrower is, in effect, realizing the capital value representing the difference between the rate of interest being charged on the existing agreement and the increased rate at which the purchaser would otherwise have to arrange financing. If the lender is able to call the loan and relend the money at the increased rate, it is the lender, and not the borrower, who will obtain that capital value.

Lenders insist that due-on-sale clauses are not used to capitalize on increased rates, but are used mainly to control the assignment of the security agreement to a purchaser who is not creditworthy. They emphasize that a lender's decision to make a typical residential mortgage loan depends on a consideration of both the value of the security and the personal creditworthiness of the borrower. Accordingly, the substitution of a person who is less financially sound may prejudice the lender. They acknowledge that, in the event of default, a lender can usually exercise various remedies against the land, as well as against both the original borrower and the purchaser. However, they emphasize that the time, trouble, and costs involved in pursuing these remedies are considerable, even if the total debt is eventually recovered. Lenders prefer to receive regular loan payments, rather than to sell or foreclose the security. Moreover, they find little comfort in the fact that recourse may be available against both the original borrower and the purchaser, since the former will often be difficult to locate and the latter will obviously be in financial trouble. For these reasons, a lender will generally prefer to call the loan upon a sale of the secured property by the borrower.[83]

(iii) The Law in the United States

The use of due-on-sale clauses is widespread in the United States and has been the subject of a controversy that has spawned an enormous amount of both judicial and academic comment.[84] The decisions of the American courts on the validity of due-on-sale clauses are largely irreconcilable. The arguments in both the case law and the commentaries raise a variety of issues, including whether such clauses constitute a restraint on alienation, whether they are reasonable or unconscionable, and whether general social policy should favour the borrower or the lender.[85] There has been no satisfactory judicial resolution of the conflicting views.

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[82] Gibson, "Due-on-sale Clauses: Separating Social Interests from Individual Interests" (1982), 35 Vand. L. Rev. 357.

[83] See *infra*, chs. 8, 9, and 10, concerning, respectively, foreclosure and sale, actions on the covenant, and possession of the secured property.

Section 3-208 of the Uniform Land Transactions Act[86] has resolved this contentious issue in favour of lenders. Section 3-208(a) specifically validates the use of due-on-sale clauses. As the Comment points out, the clause restricts the power of a borrower to sell the favourable interest rate where rates have risen.

Section 3-208(b), nevertheless, limits the practice of some lenders who include in the security agreement both a due-on-sale clause and a clause requiring a prepayment penalty when the loan is called. Where the agreement contains both clauses, the borrower not only loses the benefit of the sale of the lower interest rate, but is also subject to a penalty for prepayment that has been triggered when the lender calls the loan. Section 3-208(b) provides that, notwithstanding any agreement to the contrary, if a lender demands a rate of interest higher than that specified in the security agreement, or any other consideration, as a condition of approving a transfer by a protected party[87] of his or her interest in residential real estate, and the higher rate or other consideration is not accepted by the borrower, a prepayment penalty may not be charged, provided that the debt is paid in full within three months after such failure to agree.

(iv) Proposals for Reform

As indicated earlier, it has been suggested by some commentators that a due-on-sale clause gives a lender an unfair advantage over a borrower and that sound social policy favours a regime that would allow borrowers, or at least protected borrowers, to obtain the benefit of selling the favourable interest rate to a purchaser of the secured property. Those who take this position argue, therefore, that the use of due-on-sale clauses should be prohibited, or prohibited with respect to protected borrowers.

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[84] See, generally, Dunn and Nowinski, "Enforcement of Due-on-Transfer Clauses: An Update" (1981), 16 Real Prop. Prob. & Tr. J. 291. The table of cases in this article lists 60 federal and state cases from 24 states. See, also, Nelson and Whitman, *Real Estate Finance Law* (2d ed., 1985), at 316-30.

[85] See, for example, *Occidental Savings and Loan Assoc. v. Venco Partnership*, 293 N.W. 2d 843 (Neb. Sup. Ct. 1980), *Wellenkamp v. Bank of America*, 582 P.2d 970 (Cal. Sup. Ct. 1978), and Cohen, "Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability" (1975), 27 Stan. L. Rev. 1109.

[86] *Supra*, note 52.

[87] A "protected party" is defined in § 1-203 and is discussed *supra*, ch. 4, sec. 4.

However, it is difficult to know what result is socially desirable with regard to due-on-sale clauses. It is clear that such clauses are of economic value to lenders. A general prohibition of due-on-sale clauses could have the effect of forcing lenders to opt for shorter terms. The resulting increase in the transaction costs of lending would prompt either a rise in interest rates generally or the more frequent payment of such costs by each borrower. On balance, we believe that a general statutory prohibition of due-on-sale clauses would not be of overall benefit to borrowers as a class. We recognize, as well, that lenders' concerns regarding the creditworthiness of the purchaser of the secured property are legitimate.

The Commission has attempted to arrive at a solution that balances the interests of both borrowers and lenders. As the law now stands, there is no "down-side risk" for the lender in the use of a due-on-sale clause. If interest rates have risen at the time of sale, a lender can call the loan and relend the money at the increased rate. If interest rates have fallen at the time of sale, a lender can let the loan agreement run its term at the original interest rate, while retaining the right to recover the debt from both the original borrower and the purchaser; or, alternatively, the lender can require that the borrower pay a prepayment penalty if the purchaser wishes to take the property free of the existing security interest.

In order to balance the risks and benefits, we recommend that a lender should be entitled to include a due-on-sale clause in the security agreement, subject to the following limitation. Where a security agreement contains a due-on-sale clause, the borrower, upon a good faith sale of the secured property to an unrelated purchaser, should have the right to prepay the loan without any compensation to the lender.[88] The term "unrelated purchaser" should be defined to mean a purchaser who is an individual, or a corporation controlled directly or indirectly by an individual, where the individual is not connected to the borrower by blood relationship, marriage, or adoption.[89]

If, in using a due-on-sale clause, the lender intends to capitalize on a possible rise in interest rates, this proposal will balance that potential benefit against the possibility that interest rates may fall and the borrower will want to sell the property free of the security agreement. In such a case, the lender may have to forgo any prepayment penalty that he or she might otherwise have required from the borrower. If the lender's overriding concern is to control the risk that a purchaser may not be creditworthy, that control is retained at the potential cost of forgoing compensation for prepayment by the borrower.[90]

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[88] Draft Act, s. 5.3(2) and (3).

[89] *Ibid.*, s. 5.3(1)(b).

[90] In a later chapter of this Report, we shall recommend that a lender should continue to have the right to sue the borrower on the personal covenant unless, in the case of a sale of the property by a protected borrower, the lender has consented to the assumption by the purchaser of the obligations under the security agreement. The right of a lender to

In attempting to reach a solution, we recognized that some borrowers may attempt to set up a sham sale, so as to avoid giving the lender compensation for prepayment. Consequently, we recommended that the sale should have to be in good faith and to an unrelated purchaser. We believe that some further provision must be made to ensure that the sale that triggers the proposed right of prepayment without penalty is, in fact, in good faith, and not merely a device to defraud the lender. Accordingly, we recommend that a lender should be entitled to see, on demand, the agreement of purchase and sale and the affidavit of transfer that is required under the *Land Transfer Tax Act*.[91] Any dispute regarding the exercise of the right to prepay should be resolved by application of either party to the court.[92]

Finally, consistent with our underlying general policy of non-interference with commercial arrangements, the Commission recommends that the provisions proposed above with respect to due-on-sale clauses should be limited to security agreements where one of the parties is a protected borrower.

(b) DUE-ON-ENCUMBRANCE AND DUE-ON-NEGOTIATION CLAUSES

(i) Present Law

Occasionally, a clause will be inserted in a security agreement that gives the lender the option to call the loan if a subsequent encumbrance has been registered against the secured property or if the borrower has merely started negotiations for the subsequent financing or sale of the property. The former type of clause is referred to as a due-on-encumbrance clause, while the latter is referred to as a due-on-negotiation clause. As with due-on-sale clauses, there is nothing in the law of Ontario to prevent a lender from attempting to provide for such rights in the security agreement.

(ii) Deficiencies in the Law and the Case for Reform

The justification given by lenders for the use of the due-on-encumbrance clause is that the lender's position may be jeopardized if the borrower's equity is diminished, or if the borrower becomes less able to make the payments, due to the increased financial burden of another encumbrance. However, critics argue that the risk to the lender arising from an additional subsequent encumbrance on the property is often relatively trivial. A due-on-encumbrance clause fails to discriminate, for example, between a small second mortgage, to cover a single, unexpected expense, and a large second mortgage to finance a highly speculative venture.

Moreover, critics assert that the clause is a heavy handed and inappropriate instrument to provide the protection sought. They emphasize that the value of the security may be effectively reduced for a number of reasons, including a

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withhold consent in the case of an uncreditworthy transferee, together with his or her rights to proceed against the original borrower on the covenant and to proceed against the land, should provide ample protection to lenders: see *infra*, ch. 9, sec. 3.

[91] R.S.O. 1980, c. 231, s. 4. See draft Act, s. 5.3(4).

[92] *Ibid.*, s. 5.3(8).

general decline in the housing market, or the advent of some less desirable use of properties in the vicinity. Similarly, the ability of a borrower to meet the loan payments may be affected by unemployment, sickness, separation, or divorce.

With respect to due-on-negotiation clauses, we believe that their use is difficult to justify on any ground. There can be no argument that a mere attempt by the borrower to sell or encumber the property jeopardizes the lender's position in any way.

Arguably, the types of clause described above merely provide lenders with the opportunity to force a refinancing at a higher rate of interest. In addition, it is very difficult to ensure that a borrower understands the significance of such clauses so as not to be taken by surprise when they become operative.

(iii) Proposals for Reform

The Commission shares the views of the critics of due-on-encumbrance and due-on-negotiation clauses, at least as they apply to security agreements involving protected borrowers. In the main, they represent a degree of opportunism that we believe is both undesirable and unnecessary. Accordingly, we recommend that, in a security agreement involving a protected borrower, a clause should be void and unenforceable where that clause gives the lender the option to call the loan if (1) the borrower commences negotiations for a sale or subsequent encumbrance of the property; (2) the borrower enters into a subsequent security agreement; (3) the secured property is encumbered by an interest that is subsequent in priority to the security interest; (4) the borrower defaults under a subsequent encumbrance; or (5) a prior security agreement is renewed in accordance with its terms.[93]

We should emphasize that this prohibition should be limited, for the most part, to encumbrances that are subsequent in priority to the lender's security interest. For instance, certain statutory liens that are registered subsequent in time to the security agreement may, nevertheless, have priority over that agreement. Our recommendation is not intended to prevent a lender from calling the loan in cases where such statutory liens or other interests are registered against the secured property at some time after the lender's security agreement, but have priority over the lender's interest.

5. INSURANCE

(a) PRESENT LAW

Lenders invariably require the borrower to insure the secured property against damage or loss. The standard contractual requirement imposed by lenders is that the insurance coverage must be for at least the total amount of the secured loan.

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[93] *Ibid.*, s. 5.3(7). With respect to renewal of a prior security agreement, see *supra*, ch. 5, sec. 3(c).

Lenders enjoy a privileged position under both the *Insurance Act*[94] and the *Mortgages Act*.[95] Section 124 of the *Insurance Act* provides that an insurer must notify the lender if the insurance policy on the secured premises is to be cancelled. This provision is to allow the lender to protect the secured property by obtaining alternative insurance coverage where the borrower has failed to do so.

Section 6(1) of the *Mortgages Act* provides that the lender is entitled to require that the insurance proceeds "payable to a mortgagor" in respect of damage to or destruction of the secured property shall be applied to make good the loss or damage. Section 6(2) provides that, "[w]ithout prejudice to any obligation to the contrary imposed by law or by special contract, a mortgagee may require that all money received on an insurance of the mortgaged property be applied in or towards the discharge of the money due under his mortgage".

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

(i) The Requirement to Insure for the Total Loan Amount

Borrowers have objected to the requirement imposed by lenders that the property must be insured to at least the full value of the loan. The loan amount often reflects the value of both the land and the buildings; accordingly, the borrower is frequently required to pay insurance premiums on an amount far in excess of the replacement costs of the building. Borrowers consider this requirement to be unreasonable and of benefit to neither the lender nor the borrower. Indeed, the only beneficiary of this requirement is the insurer, since, regardless of the position of the lender under a policy of insurance taken by the borrower, no more can be recovered from the insurer than the actual value of the property insured under the policy. Nevertheless, the lender's current requirement that the borrower insure to at least the total amount of the loan allows the insurer to collect premiums in respect of an amount of insurance that it may never be called upon to pay.

(ii) The Application of Insurance Proceeds to Discharge the Security Agreement

Objections have also been raised to the power given to lenders under section 6(2) of the *Mortgages Act* effectively to call the loan, by requiring that insurance proceeds be applied toward the discharge of the amount due to the lender. Critics say that this puts a borrower, particularly a protected borrower, in an impossible position. The borrower may find himself or herself with neither the funds to replace or repair the buildings nor the collateral to raise alternative financing. It has been suggested that a lender is most likely to use the insurance proceeds to discharge the loan where interest rates have risen sufficiently to make it profitable for the lender to call the loan and relend the money at a higher rate. A borrower, in a time of great distress, may be left without recourse.

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[94] R.S.O. 1980, c. 218.

[95] *Supra*, note 2.

Lenders respond that to allow the borrower to use the insurance proceeds to rebuild would mean that a lender would, in effect, be required to finance a construction loan, without the protections or benefits involved in such financing. They emphasize that this can be of particular concern where the buildings are of a commercial nature, involving longer and more complex construction than residential buildings.

(c) PROPOSALS FOR REFORM

(i) The Requirement to Insure for the Total Loan Amount

We are of the view that it is unreasonable and unnecessary for lenders to require that the secured property be insured to the full amount of the loan if that amount exceeds the replacement cost of the buildings and fixtures on the land. Accordingly, we recommend that a borrower should not be required to insure the secured property for an amount in excess of the replacement value of the buildings and fixtures on that property.[96]

(ii) The Application of Insurance Proceeds

We believe that, on this issue, a distinction should be drawn once again between protected and non-protected borrowers. We recognize that lenders' concerns regarding the rebuilding of commercial premises are legitimate and that parties to most commercial transactions are able to negotiate a mutually acceptable agreement regarding the application of insurance proceeds. We are of the view, however, that protected borrowers, and particularly residential borrowers, are unlikely to turn their minds to a matter such as this, although the application of insurance proceeds may be of crucial importance if, for example, the residence is destroyed. Moreover, even if they were to consider the issue, the financial leverage of most protected borrowers is such that they rarely are able to settle it in their favour.

The Commission recommends, therefore, that the following recommendations should govern the disposition of insurance proceeds where the security agreement is not a residential security agreement. First, unless the security agreement provides to the contrary, all proceeds payable to the borrower on an insurance of the secured property should, if the lender so requires, be applied by the borrower in repairing or replacing the buildings and fixtures in respect of which the proceeds have been received.[97] Secondly, subject to any obligation to the contrary imposed by law or by special contract, the lender should be entitled to require insurance proceeds to be paid directly to him or her.[98]

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[96] Draft Act, s. 3.14(2).

[97] *Ibid.*, s. 3.14(3).

[98] *Ibid.*, s. 3.14(4).

Where, however, the security agreement involves a protected borrower, we do not believe that the foregoing proposals should apply. Rather, we recommend that the protected borrower should be entitled to require that the proceeds be applied towards repair or replacement of the damaged premises.[99] In order that this protection is not subject to waiver by the borrower through the lender's use of a standard waiver clause in every security agreement, we recommend that a protected borrower should be entitled to have the proceeds applied to repair or replacement notwithstanding any agreement to the contrary that is entered into prior to the damage or loss.[100] A lender and a protected borrower should, nevertheless, be entitled to agree that such proceeds shall be paid to and held by the lender in trust, to be disbursed in making such repair or replacement.[101] Moreover, after the damage or loss has arisen, the borrower should be entitled to agree in writing that the insurance proceeds be paid directly to the lender.[102] We believe that, at this later stage, the borrower will have a clear idea of his or her situation and the available options and, therefore, should have the right to resolve the issue in what is perceived to be the borrower's best interests.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The prepayment rights of a borrower who is not a protected borrower should be governed by the terms of the security agreement.

2. A borrower who is a protected borrower should be entitled to prepay the loan at any time, provided that the lender is fully compensated for the actual damages incurred as a result of the prepayment. Full compensation to the lender should include not only compensation for loss of interest where the interest rate at the date of prepayment has fallen ("prepayment compensation"), but also the transaction costs involved in making a new loan.

3. The *Land Security Act* should provide a formula for determining the value of such prepayment compensation to the lender. The compensation should represent the present value of the difference between the amount the lender would have earned under the security agreement, and the amount that, at current market rates of interest (the "current interest rate"), the lender would now earn in a substitute investment.

4. (1) The *Land Security Act* should specify how the current interest rate should be calculated for the purpose of the formula used to determine the appropriate prepayment compensation.

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[99] *Ibid.*, s. 3.14(5).

[100] *Ibid.*, ss. 2.5 and 3.14(6)(b).

[101] *Ibid.*, s. 3.14(5).

[102] *Ibid.*, s. 3.14(6).

(2) Ordinarily, the current interest rate that should be used in the proposed formula should be the current rate for the lender's potential substitute investment.

(3) Alternatively, the parties should be entitled to provide in the security agreement that, for the purpose of prepayment of the agreement, the current interest rate shall be calculated with reference to a lender that is in the business of making loans secured by security agreements similar to the borrower's security agreement.

(4) If the lender does not have a current rate for a potential substitute investment at the time of prepayment, the market rate should be used.

5. The amount of compensation for the transaction costs incurred by a lender (see Recommendation 2) should be the lesser of one month's interest or an amount prescribed by regulation.

6. Any dispute regarding the amount due under the security agreement or the amount of compensation to which the lender is entitled should be resolved by an application to the court.

7. With respect to the method of exercising the protected borrower's proposed right of prepayment, the borrower should be entitled, by notice, to require from the lender a statement of account, in prescribed form, as proposed in Recommendations 23 *et seq*.

8. The borrower's request for a statement of account should specify the statement of account is for the purpose of prepayment and should be served on the lender in the manner proposed in Recommendations 2(1) and (2)(a) of chapter 11.

9. The borrower's request for a statement of account should also specify the date upon which the statement is to be effective, which should be a date not more than thirty days after the date of the notice.

10. The prepayment statement of account should be provided within fifteen business days after the date on which service of the notice from the borrower requesting the statement is effective. If the lender fails to provide the statement as required, the borrower should be entitled to have recourse to the procedure recommended below with respect to obtaining a discharge (see Recommendations 18-19).

11. In addition to the information that should be contained in a conventional statement of account (see Recommendation 26), for the purpose of prepayment the statement should also show the prepayment compensation and transaction costs required to be paid, as well as the method by which such amounts were calculated.

12. Prepayment should not merely suspend the running of interest, as is now the case under section 17 of the *Mortgages Act* and section 10 of the *Interest Act*. Rather, upon being paid or tendered the outstanding principal and compensation, in the amount determined, the lender should be required to give the borrower a discharge in registrable form at no cost to the borrower.

13. Sections 16 and 17 of the *Mortgages Act* should be repealed and the Parliament of Canada should be requested to amend section 10 of the *Interest Act* so that it does not apply to Ontario.

14. (1) As soon as the obligation whose performance is secured by the security agreement is performed, or the borrower is otherwise entitled to a discharge, the lender should be required to prepare a discharge of the security agreement in registrable form, as well as a release of insurance and discharge of any collateral security, in registrable form, without charge to the borrower.

    (2) The lender should serve the discharge and other documents on the borrower within ten business days of the date on which the borrower is entitled to the discharge.

15. The borrower should continue to have the responsibility of registering the discharge.

16. The discharge should be accompanied by a notice stating clearly that the discharge should be registered in the appropriate land registry office, and setting out the address of that office.

17. Where the lender fails, without reasonable excuse, to prepare and deliver the discharge of the security agreement and any release of insurance and discharges of collateral security within the stipulated time, the lender should be liable for any loss or damage caused thereby.

18. Where the lender fails, without reasonable excuse, to prepare and deliver the discharge and other documents, as proposed above, the borrower should be entitled to serve on the lender a written request for the discharge, and the lender should be required to deliver the discharge and other documents to the borrower within ten business days after receipt of this request.

19. (1) If the lender fails to make such delivery, the borrower should be entitled to apply to the court for relief.

    (2) Where the court is satisfied that all money due under the agreement has been paid and all covenants have been performed, the court should have the power either to order the lender to provide a discharge of the security agreement in registrable form, a release of insurance, and a discharge of any collateral security in registrable

form, or to make an order discharging the security agreement, releasing any insurance, and discharging any collateral security.

20. (1) When a borrower or any person entitled to pay off a security agreement desires to do so and the lender cannot be found, or where from any other cause a proper discharge cannot be obtained, or cannot be obtained without undue delay and expense, on the application of the borrower or the person entitled to pay off the security agreement, the court should be empowered to direct payment into court of the amount due under the security agreement and to make an order discharging that agreement, releasing any insurance on the property, and discharging any collateral security.

(2) The money paid into court should be paid out to the lender or as the court may direct.

(3) The court should be empowered to require notice to be given to the lender or those claiming under the lender, either before or after making the order, by advertisement or in any other manner as is considered proper.

21. Where an issue arises as to who is entitled to receive payment or as to the reasonableness or amount of the payment, the court should be empowered, as a condition of making an order, to require payment into court of a sum in excess of the amount admitted to be due and to answer any claim by the lender for subsequent interest and costs. The sum paid into court should be subject to the further order of the court, and the court should be empowered to require payment into court of an additional sum.

22. Where the court makes an order discharging the security agreement, releasing any insurance, and discharging any collateral security, the borrower should be entitled to register the order in the proper land registry office, and the registered order should be conclusive of the matters determined in the order and should have the same effect as the registration of a certificate of discharge signed by the lender.

23. (1) The borrower and any subsequent encumbrancer who has the right to remedy the borrower's default should be entitled, by a notice in writing, to require a lender to provide a statement of account at any time.

(2) The notice should be served on the lender in the manner proposed in Recommendations 2(1) and (2)(a) of chapter 11.

(3) The notice should state that the statement of account is required for the purpose of prepayment, if such is the case, state the date upon which the statement of account is to be effective, which should be a date not more than thirty days after the date of the notice, and enclose the prescribed fee.

24. The lender should be required to serve the statement of account on the person serving the notice within fifteen business days after the date on which service of the notice is effective.

25. (1) The borrower should be entitled to receive one free statement of account within every twelve month period after the date of the execution of the security agreement. Subsequent encumbrancers, however, should be required to pay the prescribed fee in all cases.

(2) Where the borrower requests any additional statements within the twelve month period, he or she should be required to pay, in advance, the lender's reasonable costs of producing each additional statement. A maximum charge for such a statement should be established by regulation and the initial maximum amount should be $25.

26. (1) For the purpose of paragraph (2), "period" should be defined to mean:

(a) the period between the date the last amount on account of principal was advanced to the borrower under the security agreement and the date of the statement of account, if no statement of account has been previously provided to the borrower; or

(b) the period between the date of the statement of account most recently provided to the borrower and the date of the requested statement of account.

(2) While the proposed statement of account need not be in any particular form, it should be in writing and should set out, in plain language, the following information:

(a) the principal amount due at the beginning of the period;

(b) the amount of payments credited during the period;

(c) the apportionment of payments credited during the period on account of principal, interest, and taxes, or any other matters;

(d) the amount of any payments made by the lender and charged to the security agreement during the period and indicating the nature of the payments;

(e) the status of the tax or any other accounts maintained by the lender in respect of the security agreement at the end of the period;

(f) the principal amount due at the end of the period and the method by which the amount was calculated;

(g) the interest rate or rates charged on the security agreement during the period, including the rate on the date of the statement of account;

(h) the amount of any charge assessed against the borrower arising out of the borrower's default, if any, and the nature of the charge;

(i) the amount, if any, required to be paid to bring the security agreement into good standing;

(j) if the statement of account is required for the purpose of prepaying the security agreement, the compensation required to be paid and the method by which the compensation was calculated;

(k) if the effective date specified in the request for a statement of account requires the lender to assume that certain payments will be made before the effective date, a statement that it is correct only if such payments are duly made; and

(l) such other information as may be prescribed.

27. The obligation to provide a statement of account upon request should apply to all lenders, whether or not the borrower is a protected borrower.

28. The statement of account should be effective as of the date specified in the notice requesting the statement, which would be a date not more than thirty days after the date of the notice (see Recommendations 9 and 23(3)).

29. The statement of account should bind the lender in favour of the person requesting the statement and any person to whom the lender might reasonably expect such person to provide the statement, if the statement is reasonably relied upon to the recipient's detriment.

30. (1) Subject to Recommendation 26(k), the lender should not be entitled to qualify the statement of account, or obtain a waiver of liability through the use of a disclaimer or an "errors and omissions excepted" clause, where the statement of account has been provided by the lender after a written request has been made by the borrower or subsequent encumbrancer.

(2) The lender should be entitled to include an "errors and omissions excepted" clause on an informal, unsolicited statement, provided that the statement also clearly indicates that it is an informal, non-binding statement only and that a borrower or subsequent encumbrancer who wishes to rely on the completeness and accuracy of a

statement must make a written request to the lender for a formal statement of account that will bind the lender.

31. (1) Except where a statement of account is issued by the court (see Recommendation 32(2)), the lender should be entitled to notify a person who has received a statement that an error has been made, and to provide that person with an amended statement of account.

(2) However, the lender should remain liable for any loss that has been suffered as a result of reasonable reliance on the original statement.

(3) The onus should be on the lender to determine from the person requesting the statement whether an incorrect statement has been given to a third party and to deliver to that party an amended statement. Until the lender does so, the lender's potential liability to the third party should continue.

(4) At the lender's request, any person who has received a statement of account should be required to provide forthwith to the lender the names and addresses of those persons who he or she knows or ought to know have received a copy of a statement of account.

(5) Where the person who has received a statement of account fails to comply with the preceding obligation or is negligent in providing the requisite information, the lender should remain liable directly to a third party who has suffered a loss after reasonably relying on an incorrect statement. However, the lender should be able to seek indemnification from the person from whom the information has been requested for any damages paid by the lender to that party.

32. (1) If the lender fails to produce a binding statement of account within the proposed fifteen day period (see Recommendation 24), the borrower should be entitled to apply to the court to obtain the statement.

(2) The court should be empowered either to order the lender to prepare and issue the statement of account or to prepare and issue the statement itself.

33. A dispute regarding the accuracy or sufficiency of the statement of account should be resolved by application to the court of any interested person.

34. (1) Where the lender fails, without reasonable excuse, to deliver the required statement:

(a) the lender should be liable, on the application of the person requesting the statement, for any loss or damage caused to the applicant, and

(b) the lender should be guilty of an offence and subject to a fine of not more than $2,000.

35. Recommendations 36-39, dealing with due-on-sale clauses, should apply only to security agreements where one of the parties is a protected borrower.

36. A lender should be entitled to include a due-on-sale clause in the security agreement, subject to the proviso that, where a security agreement contains a due-on-sale clause, the borrower, upon a good faith sale of the secured property to an unrelated purchaser, should have the right to prepay the loan without any compensation to the lender.

37. The term "unrelated purchaser" should be defined to mean a purchaser who is an individual, or a corporation controlled directly or indirectly by an individual, where the individual is not connected to the borrower by blood relationship, marriage, or adoption.

38. A lender should be entitled to see, on demand, the agreement of purchase and sale and the affidavit of transfer that is required under the *Land Transfer Tax Act*.

39. Any dispute regarding the right to prepay should be resolved by application of either party to the court.

40. (1) In a security agreement involving a protected borrower, a clause should be void and unenforceable where that clause gives the lender the option to call the loan if:

(a) the borrower commences negotiations for a sale or subsequent encumbrance of the property;

(b) the borrower enters into a subsequent security agreement;

(c) the secured property is encumbered by an interest that is subsequent in priority to the security interest;

(d) the borrower defaults under a subsequent encumbrance; or

(e) a prior security agreement is renewed in accordance with its terms.

(2) The recommendation in paragraph (1) should not be interpreted to prevent a lender from calling the loan in cases where a statutory lien or other interest is registered against the secured property after the lender's security agreement, but has priority over the lender's interest.

41. A borrower should not be required to insure the secured property for an amount in excess of the replacement value of the buildings and fixtures on that property.

42. (1) Where the security agreement is not a residential security agreement:

    (a) unless the security agreement provides to the contrary, all proceeds payable to a borrower on an insurance of the secured property should, if the lender so requires, be applied by the borrower in repairing or replacing the buildings and fixtures in respect of which the proceeds are received; and

    (b) subject to any obligation to the contrary imposed by law or by special contract, a lender should be entitled to require proceeds payable on an insurance of the secured property to be paid directly to the lender.

    (2) Where the security agreement is a residential security agreement:

    (a) subject to subparagraphs (b) and (c), the protected borrower should be entitled to require that the insurance proceeds be applied towards repair or replacement of the damaged premises, notwithstanding any agreement to the contrary that is entered into prior to the damage or loss;

    (b) the protected borrower and the lender should be entitled to agree that the insurance proceeds shall be paid to and held by the lender in trust, to be disbursed in making such repair or replacement; and

    (c) after the damage or loss has arisen, the protected borrower should be entitled to agree in writing that the insurance proceeds be paid directly to the lender.

CHAPTER 7

DISCLOSURE OF INFORMATION TO BORROWERS

1. INTRODUCTION

As we have discussed in the context of the protected borrower,[1] one aspect of the developing trend in "consumer protection" law has been the imposition of a requirement upon commercial parties to disclose certain critical information to uninformed or unsophisticated consumers, in order to equalize, as far as possible, the bargaining power of the parties. In light of this trend, we believe that disclosure of relevant information, particularly to protected borrowers, should be a central aspect of our proposals for reform of the law of mortgages.

In order to achieve this end, two principal aims should underlie proposals regarding disclosure. The first is to give to potential borrowers the wherewithal to make intelligent and informed comparisons among the terms offered by those who have funds to lend pursuant to a security agreement. To further this aim, the requisite information must be communicated in a standardized, comprehensible way. The second is to ensure that the details of the arrangement that has been made, and, in particular, the exact nature of the consequences that may follow from a breach of the borrower's obligations, have been outlined to the borrower in terms that the borrower can easily understand.

In order to put in perspective the issues and subsequent recommendations relating to disclosure, it is necessary to describe the various stages of a typical mortgage relationship.

Information with respect to interest rates quoted by institutional lenders is generally widely available and frequently reproduced in newspapers. Where a prospective borrower sees an advertisement by a bank or trust company announcing the interest rates for secured loans, he or she may approach a lender to make initial inquiries. Very often, a borrower will choose a particular lender on the basis of an existing relationship with that lender or on the basis of a recommendation from a real estate agent or another party. Many trust companies, in particular, have an associated real estate business.

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[1] See *supra*, ch. 4, sec. 2.

It is the typical practice of institutional lenders to have what is frequently called a loans officer to whom the customer will be referred. Often this officer will have available a brochure stating the general terms governing a secured loan at that institution. A borrower may or may not use such information for the purpose of comparison of the terms of one lender against those of another.

If the prospective borrower decides to request a loan, the lender will ask that a loan application be completed, providing details both of the borrower's financial resources and of the property that will secure the loan. A borrower will ordinarily pay in advance, or agree to pay, the costs associated with an appraisal and, occasionally, a survey, of the property.

If the prospective borrower is approved, the lender generally will make a written commitment in the form of a letter. This commitment letter will usually set out the principal features of the loan, including the amount, interest rate, term, amortization period, rights of prepayment, amount and due dates of the periodic payments, and other features considered by the lender to be necessary terms of the agreement.

Where a loan is to be secured by residential property, the borrower is not generally obliged to accept the offer made by the lender in the commitment letter, although the cost of the appraisal and survey is not refundable even if the commitment is not accepted. The lender, on the other hand, ordinarily will make the loan in accordance with the commitment letter, unless something unexpected should subsequently occur that would significantly alter the effect of the proposed agreement. The lender generally will not raise the rate above that stated in the commitment letter. However, a lender will often agree to reduce the interest rate, should the lender's standard rate fall between the date of the commitment and the date on which the loan is actually made.

The borrower is expected to make a formal written acceptance of the commitment. We have been advised that there is a virtually complete absence of litigation over such commitments in residential transactions. This suggests that, except possibly where interest rates are fluctuating substantially, there are few problems with existing arrangements at this stage.

Where the loan is made for the purpose of buying the secured property, the security agreement, usually in the lender's standard form, generally will be signed by the borrower before the closing of the sale transaction. After the closing, a copy of the security agreement will be forwarded by the lender's solicitor to the purchaser or his or her solicitor. Where the loan is made for the purpose of a refinancing, a similar procedure is generally followed.

Where a borrower defaults in his or her obligations under the security agreement, the lender will often take steps to discover the reason for the default and to see if there are ways in which the default can be remedied, rather than immediately initiating legal proceedings. A defaulting borrower usually will be advised in writing that default proceedings may be initiated, for example, under the lender's power of sale, and the borrower will be reminded that he or she is liable for legal fees that are incurred if proceedings must be taken to recover the debt. If the borrower fails to remedy the default after such notice, proceedings will be started.

It is against this background that the disclosure requirements must be considered. In the first major section that follows, we shall deal with general disclosure requirements, leaving until the next main section a particular aspect of full disclosure, namely, the use of "plain language" in disclosure statements and in the security agreement.

2. GENERAL DISCLOSURE REQUIREMENTS

(a) PRESENT LAW

(i) Ontario Legislation

Disclosure requirements currently exist in a number of Ontario statutes. The most relevant for our purposes are the *Mortgage Brokers Act*,[2] the *Land Titles Act*,[3] the *Mortgages Act*,[4] the *Land Registration Reform Act, 1984*,[5] and, for comparison, the *Consumer Protection Act*.[6]

The disclosure provisions of the *Mortgage Brokers Act*[7] are relatively narrow in scope. While there is a very broad definition of "mortgage broker", to include anyone who carries on the business of lending money on the security of real estate or who holds himself or herself out as a mortgage broker, the ambit of the Act is substantially reduced by section 2, which creates extensive exceptions to the disclosure requirements.[8] The obligation to disclose is essentially restricted to lenders who are individuals, or to consumer finance corporations that are not registered under the *Loan and Trust Corporations Act*,[9] or to brokers who are not lenders of their own money.

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[2] R.S.O. 1980, c. 295.

[3] R.S.O. 1980, c. 230.

[4] R.S.O. 1980, c. 296.

[5] S.O. 1984, c. 32.

[6] R.S.O. 1980, c. 87.

[7] *Supra*, note 2.

[8] Section 2 provides:

> 2. This Act, except sections 11 to 21, does not apply to,
>
> (a) corporations registered under the *Insurance Act* or the *Investment Contracts Act*;
>
> (b) corporations registered under the *Loan and Trust Corporations Act* that are not also registered under the *Real Estate and Business Brokers Act*;
>
> (c) banks under the *Bank Act* (Canada);
>
> (d) credit unions;
>
> (e) non-resident insurance companies loaning on the security of first mortgages or acquiring first mortgages of Ontario real estate by virtue of a licence in mortmain or under section 340 of the *Corporations Act*;
>
> (f) an employee of a party to a mortgage transaction when the employee is acting for or on behalf of his employer.

The principal obligation to disclose is found in the regulations made pursuant to the Act.[10] The disclosure requirements are in two principal forms. First, section 3(10) of the regulations requires disclosure in accordance with Form 2.[11] Form 2 identifies the secured property and sets out the following information:

(1) the principal amount of the loan;

(2) bonuses, charges, fees, and other like amounts;

(3) the amount of money to be paid to the borrower;

(4) the maximum annual effective rate of interest on the mortgage;

(5) the amount of instalment payments, indicating whether this is excluding or including interest;

(6) the date of maturity of the agreement and the amount due on that date if all payments are made;

(7) renewal information; and

(8) details of any bonuses, charges, fees, and other like amounts, to be deducted from the principal amount.

Disclosure in Form 2 must be made at least twenty-four hours before the borrower is asked to sign the security agreement. Section 3(13) of the regulations also requires that a statement containing specific details of the executed transaction must be provided to the borrower by each mortgage broker within thirty days of the closing of the transaction.[12]

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[9] R.S.O. 1980, c. 249.

[10] R.R.O. 1980, Reg. 662.

[11] Form 2 is set out *infra*, Appendix 2.

[12] Section 3(13) provides:

> 3.-(13) Within thirty days of the closing of the transaction each mortgage broker shall provide the borrower with a statement showing,
>
> (a) the principal amount of the loan;
>
> (b) the due date of each periodic payment;
>
> (c) the amount of each periodic payment;
>
> (d) the portion of each periodic payment charged as interest;
>
> (e) the portion of each periodic payment applied on principal;
>
> (f) the outstanding balance of the loan after each periodic payment;
>
> (g) the balance at maturity, if any; and

Section 93(2) of the *Land Titles Act*,[13] merely requires that charges that secure the payment of money should state "the amount of the principal sum that the charge secures, the rate of interest and the periods of payment including the due date".

Section 4(1) of the *Mortgages Act*[14] requires that a lender deliver a copy of the security agreement to the borrower or his or her representative within thirty days of having received the executed agreement from the borrower. If the lender fails to do so, the borrower may, within ten days after the thirty day period has elapsed, demand a copy of the agreement. Failure by the lender to comply with such a demand is an offence punishable by a fine of not more than $50.

The *Land Registration Reform Act, 1984*[15] establishes a disclosure requirement as part of a statutory scheme to simplify registration and reduce the volume of paper in the land titles and registry offices. In order to register a security agreement under the *Land Titles Act* or the *Registry Act*,[16] a "charge", as prescribed by Form 2 of the regulations to the *Land Registration Reform Act, 1984*,[17] must be completed.[18] The actual terms of the security agreement are included as part of the charge in one of three ways.[19]

Section 8(1) of the Act provides that a lender may file with the Director of Land Registration, "in the prescribed manner and form, a set of standard charge terms and, with the consent of the Director, may file a set of standard charge terms in a form other than the prescribed form".[20] As a result, a lender may file his or her own standard form security agreement as the "set of standard charge terms". The set is then assigned a "filing number".[21] Once this set is filed, a lender may incorporate the standard terms into the charge in Form 2 simply by referring in the charge to the filing number of the set.[22] In order to ensure that a borrower does not merely execute the charge in Form 2,

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(h) the name of the payee and the amount actually paid in respect of all charges other than brokerage fees or commissions indicated under item 8 of Form 2.

[13] *Supra*, note 3.

[14] *Supra*, note 4.

[15] *Supra*, note 5.

[16] R.S.O. 1980, c. 445.

[17] O. Reg. 580/84, s. 2(2), as am. by O. Reg. 35/85, s. 2.

[18] *Land Registration Reform Act, 1984*, *supra*, note 5, s. 3(1).

[19] In addition, under s. 7 of the Act, a charge in prescribed form is deemed to include a number of implied covenants, which may be excluded or varied. However, there is no formal mechanism by which borrowers are alerted to these implied covenants.

[20] The prescribed form is Form 2: see *supra*, note 17, s. 6(2).

[21] *Land Registration Reform Act, 1984*, *supra*, note 5, s. 8(3)(a).

[22] *Ibid.*, s. 9(1).

but also receives a copy of the actual security agreement that governs the relationship of the parties, section 11 of the Act provides that a lender who does not provide the borrower with a copy of the set of standard charge terms, prior to taking a charge under the Act, is guilty of an offence and subject to a fine of not more than $5,000. Moreover, all sets of standard charge terms filed with the Director of Land Registration are open for public inspection, copying, and purchase.[23]

Where no set of standard charge terms has been filed by the lender pursuant to section 8, a copy of the security agreement must be appended as a schedule to the charge in Form 2.[24] While Form 2 must be executed by the borrower in order to be registrable, the Act does not make it clear whether, in addition, the appended security agreement must be formally executed.

The *Land Registration Reform Act, 1984* also establishes a further mechanism that may be used to incorporate standard terms into a charge, without appending to it a security agreement. Section 7(5) of the Act provides that a "charge in the prescribed form shall be deemed to include the prescribed standard charge terms [that is, terms that are prescribed by regulation], unless a set of standard charge terms filed under section 8(1) is referred to in the charge by its filing number". However, no such standard terms have as yet been prescribed by regulation. Moreover, there appears to be no requirement, analogous to section 11, that lenders make disclosure of any standard charge terms that may be prescribed.

Although the provisions of the *Consumer Protection Act*[25] do not apply to land security agreements,[26] the Act contains a useful example of statutory disclosure requirements. Section 24 imposes an obligation on the lender to provide the borrower with a disclosure statement before credit is given. The statement must give details of the agreement, including the actual sum or cost of goods received by the borrower, the downpayment, the cost of borrowing, expressed in dollars and cents, the percentage that the cost of borrowing bears to the sum stated, expressed as an annual rate, any other fee or amount charged for insurance or for official fees, and any additional charge made upon default.

The cost of borrowing is defined in section 1 of the Act, and the method of calculating the percentage rate of interest by which this cost is expressed is prescribed by regulation.[27]

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[23] *Ibid.*, s. 8(3)(b), (4), and (5).

[24] *Ibid.*, ss. 3(1) and 4.

[25] *Supra*, note 6.

[26] While the Act regulates disclosure with respect to "credit transactions", s. 1(f) provides that "credit" "does not include credit given on the security of a mortgage of real property".

[27] R.R.O. 1980, Reg. 181, s. 21.

(ii) Federal Legislation

Two federal statutes currently impose disclosure requirements on lenders: the *Interest Act*[28] and the *Bank Act*,[29] including the *Cost of Borrowing Disclosure Regulations*, the regulations passed under the latter Act.[30]

The *Interest Act* disclosure requirement is found in section 6:

> 6. Whenever any principal money or interest secured by mortgage of real estate is, by the mortgage, made payable on the sinking fund plan, or on any plan under which the payments of principal money and interest are blended, or on any plan that involves an allowance of interest on stipulated repayments, no interest whatever shall be chargeable, payable or recoverable, on any part of the principal money advanced, unless the mortgage contains a statement showing the amount of such principal money and the rate of interest chargeable thereon, calculated yearly or half-yearly, not in advance.

The purpose of section 6 is disclosure of the true interest rate that the borrower will pay.[31] However, section 6 has been narrowly interpreted by the courts, with the result that it is largely ineffective in ensuring the intended disclosure. The term "interest" has been interpreted as not encompassing bonus payments, so that a security agreement need not necessarily disclose the actual overall cost of the loan.[32]

The meaning of "blended payments" has also been restrictively interpreted. Apparently, so long as the principal and interest can be calculated arithmetically, the requirements of section 6 are satisfied in respect of blended payments. An agreement may simply contain a statement of instalment payments, with an indication concerning which portions are principal and interest, provided that "the payments are not mixed so as to be inseparable and indistinguishable".[33]

Section 6 stipulates that principal and interest must be stated to be payable either yearly or half-yearly, not in advance. Nevertheless, the courts have held that a simple statement of an interest rate, without specifying that the payment is to be yearly or half-yearly, and not in advance, is in compliance with section 6.

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[28] R.S.C. 1970, c. I-18.

[29] Being Part I of the *Banks and Banking Law Revision Act, 1980*, S.C. 1980-81-82-83, c. 40, as en. by s. 2 of the latter Act.

[30] S.O.R./83-103.

[31] *Kilgoran Hotels Ltd. v. Samek*, [1968] S.C.R. 3, (1967), 65 D.L.R. (2d) 534, at 536 (subsequent reference is to 65 D.L.R. (2d)).

[32] *London Loan and Savings Co. v. Maegher*, [1930] S.C.R. 378, [1930] 2 D.L.R. 849, and, generally, Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977), at 662-63.

[33] *Kilgoran Hotels Ltd. v. Samek*, *supra*, note 31, at 536.

Such a statement will be interpreted to mean that payment is yearly, not in advance.[34]

Finally, under section 6, there is no standardized way of stating the interest rate that must be disclosed. The rate may be either a nominal rate or an effective rate, although the disclosure of a nominal rate may convey little useful information.

Section 202(3) of the *Bank Act*[35] prohibits a bank from making a loan without having made such disclosure as is prescribed by the regulations. The Act exempts from the disclosure requirements loans that are made to a corporation or partnership or to an individual for business purposes,[36] and any other class of loan exempted by the regulations; the *Cost of Borrowing Disclosure Regulations* under the Act[37] exempt any loan secured by a mortgage in an amount exceeding $150,000.

Section 8 of the *Cost of Borrowing Disclosure Regulations* requires that, where a loan is secured by real property, disclosure must be made in the form of Schedule II to the regulations.[38] Schedule II contains a comprehensive and detailed Statement of Disclosure, requiring the lender to set out, *inter alia*, the principal advanced, interest rate, cost of borrowing, related costs and charges (such as for mortgage insurance, inspection and appraisal fees, legal fees, and estimated disbursements), the term of the mortgage, the terms and conditions of repayment and of any variations respecting rights of repayment before maturity and respecting the term of the agreement or the interest rate, and the charges that may be imposed upon failure to repay the loan on maturity.

It is not clear at what point in the transaction a lender is required to make disclosure to the borrower in the form of Schedule II. The Act simply provides that the disclosure requirement comes into effect "where the bank makes to a person a loan". The wording of Schedule II appears to contemplate disclosure being made before the security agreement is executed, since it provides that the property "on which there *will be* a mortgage"[39] must be described at the top of the form. It is the practice of some banks to make the Schedule II disclosure at the time the borrower is advised that the loan application has been approved. Schedule II is signed at the same time as the commitment is accepted.

Section 16 of the regulations to the *Bank Act* also establishes disclosure requirements at the advertising stage. If the bank's advertisement purports to indicate a rate of interest or other charges, disclosure must be made of both the cost of borrowing,[40] expressed as an annual percentage rate, and the nature of the charges not included in the cost of borrowing. However, these disclosure requirements do not apply where the lender is responding to oral or written inquiries from the prospective borrower.

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[34] *Standard Reliance Mortgage Corp. v. Stubbs* (1917), 55 S.C.R. 422, 38 D.L.R. 435.

[35] *Supra*, note 29.

[36] *Ibid.*, s. 202(3)(e), (f), and (g).

[37] *Supra*, note 30.

[38] See *infra*, Appendix 3.

[39] Emphasis added.

Section 12 of the *Cost of Borrowing Disclosure Regulations* provides that, where any information required to be disclosed is unavailable to the bank, and the bank has made all reasonable efforts to obtain it, the bank is entitled to disclose an estimated amount, if it is clearly identified as such, if it is reasonable, if it is based on the best information available, and if it is not used for the purpose of circumventing or evading the disclosure requirements.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

As we have discussed, the first aim of any disclosure requirements is to provide a prospective borrower with the information required in order to make informed decisions about what may be his or her most significant financial transaction. The second aim is to inform the borrower of the specific details of the agreement into which the borrower has entered, including his or her rights and obligations in the event of default. While each of the existing disclosure requirements described earlier operates, to some degree, to fulfil these goals, there is currently no uniformly applicable or effective disclosure scheme to ensure that all borrowers are properly informed.

The existing provisions of the *Mortgage Brokers Act*,[41] *Land Titles Act*[42] and *Mortgages Act*[43] are largely ineffective in meeting any of the stated concerns in respect of disclosure. The kind of information required to be disclosed under Form 2 of the regulations to the *Mortgage Brokers Act*[44] would be both useful and relevant if it were made available at an earlier stage to the prospective borrower. However, the narrow definition of mortgage broker means that disclosure is not required of the vast majority of lenders; moreover, the fact that disclosure in Form 2 may be made only twenty-four hours before the borrower is asked to sign the security agreement means that the borrower is not given an adequate period of time in which to make any informed comparison of the terms of the various security agreements that may be available on the market. The provisions of the *Land Titles Act* and the *Mortgages Act* are not only ineffective in disclosing anything prior to the conclusion of the transaction, but they also do little to inform the borrower of the specifics of the agreement that has been concluded.

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[40] Defined in s. 202(2) of the *Bank Act*, *supra*, note 29. The method of calculation of the cost of borrowing is set out in s. 4 of the *Cost of Borrowing Disclosure Regulations*, *supra*, note 30.

[41] *Supra*, note 2.

[42] *Supra*, note 3.

[43] *Supra*, note 4.

[44] *Supra*, note 10.

The federal *Bank Act*[45] disclosure requirements are more effective than the various provincial requirements. Schedule II to the regulations to the Act[46] provides the kind of specific information regarding the security agreement that a borrower may need in order to understand the details of the transaction. The *Bank Act* also requires disclosure of some information at the advertising stage that may be useful to the borrower for purposes of comparison when shopping for a loan.

Nevertheless, the *Bank Act* disclosure provisions are unsatisfactory for several reasons. First, they are very limited in their scope. They apply only to loans made by federally regulated lending institutions, that is, the chartered banks, and, therefore, they fail to encompass a sizeable portion of the lending community that is subject to provincial regulation. Secondly, the requirements apply only where the loan is to an individual and for an amount less than $150,000. In the existing residential housing market, this dollar amount excludes many residential borrowers who arguably need disclosure. Finally, the disclosure requirements with respect to advertising do not apply where a lender is responding to an inquiry from a borrower, whether oral or written; they apply only to a published notice or advertisement by the lender.

In order to be fully informed and, therefore, capable of bargaining on a more equal footing with lenders, many borrowers, particularly those who are unsophisticated in financial matters, need clear and standardized information about the loan transaction at every stage, from first inquiry to formal execution, and then during the term of the security agreement, particularly where there has been default under that agreement. The goal of full disclosure is to ensure that these borrowers have access to as much information as is practical and useful at each stage of the loan relationship.

(c) PROPOSALS FOR REFORM

(i) The Disclosure Requirements

a. Introduction

Every person who borrows money on the security of his or her land requires a certain amount of information in order to negotiate to the best advantage with a lender. Borrowers who are not, under our proposals, protected borrowers[47] are likely to have, or to know how to obtain, the type of information that is required, or to have professional advisors to assist in the decision making process.

All borrowers need, and should be entitled to have, specific information regarding the agreement into which they have entered and their rights and obligations in the event of default under the security agreement. We believe, however, that it is the protected borrower alone who is in need of disclosure at the advertising or first inquiry stage and at the commitment stage.

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[45] *Supra*, note 29.

[46] *Supra*, note 30.

[47] See *supra*, ch. 4.

We have sought reform proposals that can be applied uniformly to all lenders, whether provincially or federally regulated, thereby avoiding duplication or confusion of disclosure requirements. The proposals have been developed with a view to consistency with both the existing *Bank Act*[48] disclosure requirements and the *Land Registration Reform Act, 1984*[49] forms. We have also been mindful of the fact that many lenders operate interprovincially and that, accordingly, there is value in avoiding, if possible, idiosyncratic requirements for Ontario.

The Commission's proposals contemplate disclosure at four stages of the relationship between the parties: upon advertising or first inquiry; upon commitment; upon execution of the security agreement; and upon default by the borrower.

b. Disclosure at the Stage of Advertising or First Inquiry

The general intention behind disclosure requirements at this stage is to ensure, as much as possible, the standardization of information, to discourage excessive reliance by the prospective protected borrower on any statement made at this stage, and to discourage misleading or confusing claims by lenders.

We do not believe that it is necessary to place a positive obligation on lenders to advertise rates of interest and costs of borrowing. However, it is necessary that any information regarding the rate to be charged for a loan, or the cost of borrowing, should be standardized, whether the information is contained in an advertisement or is given in response to an inquiry from a prospective borrower, in writing, by phone, or in person.

We are of the view that the requirements of section 16 of the *Bank Act* regulations are largely effective to meet these goals, subject to certain modifications. Accordingly, we recommend that, at the advertising or first inquiry stage, any representation by or on behalf of a lender[50] of the rate to be charged on a loan secured by land should disclose the "cost of borrowing",[51] expressed as an annual percentage rate or range of rates applicable to the class of loan being advertised, and the nature, but not necessarily the amount, of "other expenses"[52] not included in the cost of borrowing, that must be paid by the protected borrower.[53] This disclosure requirement should apply whether the representation is made in response to an oral or written inquiry or in an advertisement.

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[48] *Supra*, note 29.

[49] *Supra*, note 5.

[50] With respect to lenders who would be under an obligation to disclose, see *infra*, this ch., sec. 2(c)(ii), and the draft *Land Security Act* proposed by the Commission, *infra*, Appendix 1 (hereinafter referred to as "draft Act"), s. 4.1(b).

[51] *Ibid.*, s. 4.2(1)(a).

[52] *Ibid.*, s. 4.2(1)(b).

We recognize that a lender may not have all the information with respect to a prospective borrower or the secured property that would be required in order to give the exact details of the costs or charges described above. An example of a factor that might ultimately affect the interest rate is the possibility of a mortgage insurance charge. Accordingly, we recommend that a lender should be free to disclose information or explanations additional to that contained in any advertisement or statement, if the additional information or explanation is not stated, utilized, or placed so as to contradict, obscure, or distract attention from the information required to be disclosed.[54]

We further recommend that a lender should not be bound to enter into a security agreement that conforms with the lender's representations by reason only that the lender has made disclosure in compliance with the above proposals.[55]

In the Commission's view, further useful information, beyond that proposed above, can be provided by lenders in order to assist borrowers in making informed decisions regarding their choice of lender and type of security agreement. The amount and specificity of information that can be made available for comparison purposes at the advertising or first inquiry stage is of course limited, to some degree, by certain practical realities. In order to make a loan commitment, for example, a lender must have precise, accurate information regarding both the value of the property and the specific needs and creditworthiness of the borrower.

Nevertheless, a lender can provide important information regarding the lender's standard lending policies and the variety of terms that may be specifically sought by a particular prospective borrower. Examples of the sort of information that could be provided include the lender's prepayment policy, tax payment requirements, methods of repayment, and the use and significance of due-on-sale clauses.

In our view, the best way to ensure that a prospective borrower is capable of making informed comparisons would be to prepare a list of questions that prospective borrowers would be encouraged to ask of a prospective lender. Such a list of questions would specifically address those features of a security agreement with which many borrowers might not be familiar, such as rights of prepayment or due-on-sale clauses, and optional terms, such as renewal rights, and the relative cost of these features or terms.

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[53] *Ibid.*, s. 4.2(2).

[54] *Ibid.*, s. 4.2(3).

[55] *Ibid.*, s. 4.2(4).

We have considered a suggestion that a lender should also be required to disclose to a prospective borrower, who could identify the likely secured property, certain "hypothetical facts", including, for example, an estimate of the legal fees, registration fees, and mortgage insurance fees. In addition, it has been suggested that a repayment schedule might be disclosed, on the assumption that the interest rate and loan amount remain unchanged when the lender actually approves the loan. However, the Commission is of the view that this type of hypothetical information would constitute very inadequate disclosure and, in many cases, would be as likely to mislead as it would be to inform.

Accordingly, the Commission recommends that a list of suggested questions that a prospective protected borrower might ask a lender should be prepared by the Land Security Committee to be proposed by the Commission.[56] This list should be made widely available through libraries, real estate offices, and in such other ways as consumer information is now made available about such matters as home insulation, home security, and public health.

We further recommend that all lenders upon whom there is an obligation to disclose should be required to make the proposed information questionnaires in the prescribed form available to prospective borrowers at the lender's places of business, at no cost to the borrower, and to give a copy of the information questionnaire to the borrower at the lender's first opportunity.[57] With respect to the form of the response, lenders should be entitled to respond to the suggested questions in any way that they see fit. While we do not believe it is necessary that the answers be in writing, we expect that institutional lenders will develop brochures that will incorporate the questions and written answers, setting out the various terms and options available.

c. *Disclosure Upon Commitment by a Lender*

As we have discussed,[58] the typical arrangement for formalizing a specific security agreement is made in two stages. The first is the commitment letter from the lender to the borrower that is made after the requisite credit checks and appraisals have been completed. The second is the formal execution of the security agreement. The commitment letter will generally be regarded by the lender as an irrevocable offer that is open for acceptance for a specified period. Where the borrower accepts the offer of a loan upon the terms of the commitment letter, a security agreement will be prepared by the solicitor designated by the lender, and, after the usual title and other searches, the borrower will execute the security agreement.

We are of the view that the type of disclosure that is made pursuant to the regulations under the *Bank Act* is generally adequate to provide a prospective protected borrower with a detailed breakdown of the terms and costs of a security agreement. The adoption and more general application of these disclosure requirements to all lenders, including those governed by provincial legislation, will facilitate the goal of providing standarized information to all borrowers.

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[56] See *infra*, ch. 11, sec. 4.

[57] Draft Act, s. 4.3(1).

[58] *Supra*, this ch., sec. 1.

Nevertheless, the form of Schedule II, under the regulations, requires some modification, since it fails to provide for disclosure with respect to shared appreciation security agreements or price level adjustment security agreements.[59] In shared appreciation agreements, no effective rate of interest can be disclosed at the beginning of the term. A price level adjustment agreement is equivalent to a variable rate security agreement, except that the principal amount varies. Accordingly, disclosure should be made of such information.

We believe that the relevant information disclosed to a borrower should be readily comparable as between various lenders. This suggests that the most useful basis for comparison would be the availability of a figure, such as the effective interest rate, or the total cost of borrowing, expressed not as a rate of interest but as a dollar amount.

It has been suggested that both of these figures should be disclosed. However, we are of the view that, for practical reasons, it would not be particularly useful to require disclosure of the total cost of borrowing in a land security agreement. The absolute size of the figure for any such agreement is a function not only of the amount of the loan and interest rate, but also of the amortization period. This period is nearly always far longer than the term of the security agreement. The total cost of borrowing in a mortgage is usually considerable: at an interest rate of about sixteen percent, and an amortization period of twenty-five years, it is about three times the amount of the loan. Such a figure is of little real value to the borrower. If the amount of the loan and amortization period is the same for two lenders, and assuming that the method of stating the other charges and fees will be standardized, the only variable affecting the total cost of the loan will be the interest rate.

Accordingly, we recommend that, at the commitment stage, a lender should be required to provide a protected borrower with a disclosure statement in a prescribed form that would contain information of the type that satisfies the existing requirements of Schedule II of the regulations under the *Bank Act*, but modified to provide information with respect to price level adjustment agreements and shared appreciation agreements.[60] The fact that the disclosure statement would be in prescribed form would facilitate comparison shopping by borrowers.

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[59] Under a price level adjustment agreement, the lender has a right to share in any profits earned from any enterprise or transaction financed by the loan.

Under a shared appreciation agreement, the amount to be repaid as principal when the security agreement is due includes part of any increase in the value of the land, or is increased in proportion to any changes in any index or other measure reflecting the rate of inflation, between the date of the agreement and the date of repayment of the amount due.

[60] Draft Act, s. 4.4(1).

We further recommend that the disclosure statement should be given to the protected borrower at the time when the lender communicates to the borrower the terms on which the lender offers to take security from the borrower.[61] In order to allow a protected borrower an adequate period to consider the terms of the security agreement, the disclosure statement should be given not less than five business days before the borrower is required to accept the offer.[62] However, subject to the terms of the disclosure statement, a borrower should remain free to accept the commitment offer at any time after receiving the disclosure statement.[63]

There may be occasions where the terms of the offer specified in the commitment letter differ from those specified in the disclosure statement. In the event of any discrepancy between the two, we recommend that the terms of the disclosure statement should govern.[64]

d. Disclosure Upon Execution of the Security Agreement

Once the borrower has accepted the offer contained in the lender's commitment letter, the security agreement will be formally executed. As we have described,[65] a charge in Form 2 must be executed for registration under the *Land Registration Reform Act, 1984*.[66] If a set of standard charge terms has been filed by the lender pursuant to section 8, and incorporated into the Form 2 charge by reference to a filing number, the lender is required under section 11 to give the borrower a copy of the standard charge terms prior to the execution of Form 2. Where no standard charge terms are incorporated in this manner, the borrower will execute the charge in Form 2 and a copy of the security agreement must be appended as a schedule to Form 2.[67]

We consider it important that all borrowers, and not only protected borrowers, have a copy of both the registered charge in Form 2 and the security agreement governing the parties' relationship. We expect that the terms of most standard form security agreements will be filed under section 8 of the *Land Registration Reform Act, 1984*. Because section 11 provides, in effect, that the lender must give the borrower a copy of the standard charge terms filed in this manner, the section 11 disclosure requirement will satisfy the needs of borrowers in the case of most security agreements.

However, the *Land Registration Reform Act, 1984* does not require that a copy of a security agreement that is appended as a schedule to Form 2 be given to a borrower. Accordingly, we recommend that, on or before the date when the borrower signs the charge in Form 2, the lender should be required to give to the borrower a copy of the security agreement, where it is appended as a schedule to Form 2, or a copy of the standard terms filed by the lender with the Director of Land Registration.[68]

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[61] *Ibid.*

[62] *Ibid.*, s. 4.4(2).

[63] *Ibid.*, s. 4.4(3).

[64] *Ibid.*, s. 4.4(4).

[65] *Supra*, this ch., sec. 2(a)(i).

[66] *Supra*, note 5.

[67] *Ibid.*, ss. 3(1) and 4.

There may be occasions where the terms of the charge in Form 2 differ from those in the disclosure statement given to a protected borrower upon commitment. We are of the view that, as a general rule, the disclosure statement is the document that the protected borrower will consider most carefully and will believe accurately reflects the agreed terms. The borrower is less likely to give detailed consideration to the formal charge and standard charge terms or appended security agreement. Nevertheless, the registered Form 2 charge will be the document on which third parties, particularly subsequent encumbrancers, will rely in determining the nature and terms of the security agreement between the borrower and lender.

Accordingly, we recommend that, in the event of any discrepancy between the terms of the disclosure statement upon commitment and the security agreement, the following rules should apply: (1) as between the parties, the individual terms of each document most beneficial to the borrower should prevail;[69] and (2) the terms of the security agreement should govern the rights of all other persons.[70]

e. Disclosure of Statutory Rights and Obligations in the Security Agreement

Throughout this Report, we have recommended the creation in the *Land Security Act* of a wide variety of rights and obligations, particularly with respect to protected borrowers, that cannot be waived or abridged prior to default. Because the security agreement is an important document to which a protected borrower will refer during the course of his or her relationship with a lender, we are of the view that there would be great value in disclosing information with respect to such rights and remedies in the security agreement itself. However, while, at present, security agreements expressly state the contractual rights and remedies of the parties, the lender is under no obligation to describe in the agreement the statutory rights and obligations of the borrower or the lender.

We recommend that every residential security agreement should contain terms, prescribed by regulation, that disclose certain rights, obligations, and remedies of a lender and a protected borrower that are not subject to waiver or abridgement prior to default.[71] These would include such statutory rights as the right of a protected borrower to make prepayment and to obtain a statement of account or a discharge, as well as the protected borrower's rights with respect to insurance, and the rights, remedies and obligations of the protected borrower and lender arising upon default. Perhaps most importantly, there would be a term alerting the protected borrower to the fact that the rights and remedies under the land security agreement are set out in both the *Land Security Act* and, to a more limited extent, in the security agreement, and advising the protected borrower to consult the Act where he or she is in doubt regarding such rights or remedies. We have attached, as Appendix 6 to this Report, the proposed regulation that prescribes these mandatory terms.

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[68] Draft Act, s. 3.3. With respect to the Commission's recommendations concerning the "prescribed standard charge terms" under s. 7(5) of the *Land Registration Reform Act, 1984*, *supra*, note 5, see *infra*, this ch., sec. 2(c)(i)e.

[69] Draft Act, s. 4.4(5)(a).

[70] *Ibid.*, s. 4.4(5)(b).

[71] *Ibid.*, s. 3.7(1).

We further recommend that the prescribed mandatory terms should be inserted in the residential security agreement under the caption to which the subject matter of each individual term relates. The lender should be entitled to integrate the mandatory terms with other provisions in the agreement, provided that such integration does not contradict, obscure, or distract attention from the substance of the terms. Similarly, the lender should be entitled to alter the mandatory terms where the security agreement uses pronouns or other descriptions in referring to the lender, borrower, or agreement that differ from those used in the mandatory terms.

The creation of these prescribed mandatory terms would necessitate certain consequential amendments to existing statutory provisions. It will be recalled that section 7(5) of the *Land Registration Reform Act, 1984*[72] already provides a mechanism for the creation of certain prescribed standard terms that are deemed to be included in a security agreement unless a set of standard terms is filed by the lender under section 8(1) of the Act. However, no terms have yet been prescribed under section 7(5).

Further, section 7(1) of the *Land Registration Reform Act, 1984* has created certain standard implied covenants that are deemed to be included in every security agreement, although section 7(3) provides that such covenants may be expressly excluded or varied. We are concerned about the continued application of the section 7(1) covenants for a number of reasons. First, certain of the covenants would have to be revised substantially in light of the recommendations we make in this Report, for example, with respect to the rights and remedies of a lender and a borrower on default.

Secondly, we have been advised that the section 7(1) deemed covenants are widely considered by the lending community to be deficient and that these covenants are expressly excluded as a matter of course by most lenders. Indeed, it appears that most lenders who have filed standard charge terms pursuant to section 8 of the *Land Registration Reform Act, 1984* have expressly excluded the section 7(1) deemed covenants. Finally, we have recommended that all substantive provisions governing land security agreements should be centralized in the *Land Security Act*.

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[72] *Supra*, note 5.

Accordingly, we recommend that section 7(1) of the *Land Registration Reform Act, 1984* should be repealed.

Further, in view of our proposal to centralize all substantive provisions governing land security agreements in the *Land Security Act*, and having regard to recommendations made later in this chapter concerning standard terms for non-residential security agreements,[73] we recommend that section 7(5) of the *Land Registration Reform Act, 1984* should also be repealed.

f. Disclosure Upon the Borrower's Default

In order that the Commission's goals relating to disclosure are fully realized, a borrower must be informed not only of the remedies available to the lender upon default by the borrower, but also of the rights and protections that a borrower enjoys. We believe that the disclosure of this critical information is as important to non-protected borrowers as it is to protected borrowers.

In the Commission's view, the time when information relating to default will be most useful to a borrower is not at the outset of the lending relationship, but, rather, when default actually arises. As we have discussed, many lenders regard a borrower's default in missing one payment as merely an occasion for sending the borrower a reminder that the payment is overdue. We are advised that lenders often make positive efforts to assist a borrower to remedy the default, since a lender will usually prefer to obtain regular payments rather than go to the effort of exercising his or her rights in order to recover the debt. Generally, it is only where it appears that a borrower is unwilling, or is clearly unable, to make the payments due under the security agreement that the lender will initiate default proceedings. Once these proceedings have begun, the borrower is invariably faced with legal costs of approximately $500, even if the default is cured.

We believe that disclosure of the consequences of default prior to the lender's initiation of proceedings will prompt many defaulting borrowers to remedy their default. Other borrowers may not be able to bring the security agreement into good standing and may, instead, seek to refinance the debt. In either case, we are of the view that there is value in ensuring that a borrower knows both the precise state of accounts regarding the security agreement, as well as the respective rights and remedies of the borrower and lender in the event of continued default.

Accordingly, we recommend that, prior to exercising any remedy against a borrower in default, whether or not he or she is a protected borrower, the lender should be required to serve the borrower with a notice of default in prescribed form,[74] together with a statement of account showing the amount outstanding on the loan and the payment required to put the security agreement in good standing, as of the date the lender intends to commence further proceedings to enforce the security agreement.[75] The notice of default and statement of account should be served not less than ten business days after default has first occurred under the security agreement.[76] Once the notice of default and statement of account have been served, the lender should be entitled to proceed with the remedies proposed in chapters 8, 9, and 10 of this Report.

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[73] See *infra*, this ch., sec. 3(c)(ii), where we recommend, among other things, that commercial lenders should be left to develop terms that would protect their legitimate interests. The desirability of prescribing standard terms would be reviewed by the Land Security Committee, which we shall recommend in chapter 11, after the Act has been in force for five years.

The notice of default should be in writing and should set out, in plain language,[77] the default or defaults under the security agreement, the rights and remedies of the lender and the borrower on default, and such other information as may be prescribed.[78] More specifically, the borrower would be advised that he or she is entitled to retain possession of the secured property, and to make exclusive efforts to sell the property, during the proposed four month delay period,[79] after which time, if the borrower has not been successful, he or she must relinquish both possession of the property and control of the sale to the lender. The borrower would also be advised that chattels that are abandoned when possession is given up may be sold or disposed of by the lender in a commercially reasonable fashion.[80] The borrower would be informed of the lender's right to seek foreclosure in certain circumstances,[81] and of the lender's right to obtain full recovery of the secured debt by taking an action on the borrower's personal covenant contained in the security agreement.[82]

(ii) Who Must Make Disclosure?

a. Lenders and Professional Intermediaries

The function of the proposed disclosure requirements is to provide borrowers with the information they need at various stages in the prospective and finalized loan relationship. As a matter of principle, a borrower's need for this information will be the same regardless of whether the lender is an institutional lender or a non-professional lender making a single loan. Accordingly, we recommend that, for the purpose of subjecting lenders to the disclosure requirements, and subject to the exceptions proposed in the following section, the term "lender" should be broadly defined to include, for example, any person who lends money on the security of land and any person who acts for either the borrower or the lender in arranging a loan on the security of land.[83] This definition would include professional intermediaries, such as mortgage brokers, and could include other professionals, such as real estate agents or solicitors, if they are performing a function similar to that of a mortgage broker. However, it is not intended that the disclosure requirements should be imposed on such persons if they are merely facilitating the loan transaction by preparing the relevant documentation.

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[74] Draft Act, s. 6.3(1).

[75] *Ibid.*, s. 6.3(4).

[76] *Ibid.*, s. 6.3(2).

[77] See *infra*, this ch., sec. 3, regarding "plain language" requirements.

[78] Draft Act, s. 6.3(3).

[79] See *infra*, ch. 8, sec. 6(b)(iii).

[80] See *infra*, ch. 10, sec. 1(d)(v).

[81] See *infra*, ch. 8, sec. 6(c).

[82] See *infra*, ch. 9.

b. Exceptions for Certain Non-Professional Lenders

Individuals or corporations that occasionally lend money on the security of land generally will have a professional intermediary acting on their behalf. We have recommended that such a professional intermediary should be required to make the requisite disclosure. However, there are circumstances of lending by non-professional lenders in which a professional intermediary may not be involved. One such situation is where the vendor of land agrees to finance the purchase by taking back a security agreement from the purchaser. In such a case, the parties themselves may arrange for a vendor take-back without the assistance of a professional intermediary. Often, such a vendor is not financially sophisticated and, indeed, would fall within our definition of a protected borrower if he or she sought financing on the security of the property.

We have considered whether an exception in respect of the proposed disclosure requirements should be made for a vendor in a vendor take-back loan situation. While we recognize that it is desirable that all borrowers receive information about the security agreement into which they are entering, we also believe that it may be unreasonable to impose on such an unsophisticated lender the obligation to comply with the disclosure requirements before and upon commitment.

Accordingly, we recommend that an exemption from the disclosure requirements at the advertising or first inquiry stage and at the commitment stage should be created with respect to a vendor take-back security agreement, where the vendor would be a protected borrower if he or she sought financing on the security of the land purchased.[84]

We also believe that disclosure is unnecessary in certain other circumstances, such as in the case of a loan from a parent to a child, or where the loan by a non-professional is not large. Accordingly, we recommend that a further exemption should be made with respect to disclosure at the advertising or first inquiry stage and at the commitment stage where the security agreement involves a related lender[85] or where the agreement secures a loan, in an amount prescribed by regulation, by a non-professional lender who, each year, makes no more than two loans secured by an interest in land.[86] We suggest that an appropriate prescribed loan amount would be $2,000.

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[83] Draft Act, s. 4.1(b).

[84] *Ibid.*, s. 4.1(b)(ii)i.

[85] *Ibid.*, s. 4.1(b)(ii)ii. The term "related lender" is defined in s. 4.1(c).

We wish to re-emphasize two points with respect to the preceding proposals. First, in many cases involving a non-professional, exempt lender, there will, in fact, be a professional intermediary on whom a disclosure obligation will rest. In other words, the exceptions proposed above have a relatively narrow ambit, operating only where it would be unrealistic or impracticable to impose a disclosure requirement on a particular type of lender. Secondly, the exemptions apply only with respect to the disclosure upon advertising or first inquiry and the disclosure upon commitment. The disclosure provisions under the *Land Registration Reform Act, 1984*, modified as we have recommended, which require a lender to give to the borrower a copy of the charge and the standard terms filed with the Director of Land Registration, or a copy of the security agreement, should apply to every lender, without exception. Similarly, all lenders should be required to fulfil the proposed requirements of disclosure on default.

(iii) The Effect of Non-Compliance by a Lender

We expect that most lenders will comply with the various disclosure requirements that have been proposed. Institutional and professional lenders may well produce standardized brochures and disclosure forms. Nevertheless, in order to give added incentive to lenders to ensure that full disclosure is made, we believe that sanctions should be imposed for non-compliance.

There are a number of possible sanctions that could be imposed. The least stringent would be a simple fine for breach of any of the disclosure requirements. A more significant sanction would be to give the borrower the option to rescind the security agreement after the breach is discovered and after disclosure has been made. In such a case, the borrower would be entitled to repay the principal amount outstanding, less any costs that had been incurred in the loan, including the costs of an appraisal and a survey. In addition, the borrower would be entitled to be credited for any amounts paid as interest. In other words, the parties would return to the *status quo ante*. A third, and the most Draconian, sanction would be to provide that breach of the disclosure requirements would render the security agreement unenforceable. This sanction would effectively leave the lender as an unsecured creditor for the borrower's debt.

In our view, the sanction for breach of the disclosure requirements should differ for each stage of the loan process.

a. Advertising or First Inquiry Stage

We are of the opinion that a lender who fails to comply with the disclosure requirements at the advertising or first inquiry stage should be subject to a fine. Since most of the factors relating to the loan transaction would be uncertain at this stage, we believe that it would be impracticable and unjust to provide that a lender should be bound by a rate of interest that is incorrectly or misleadingly quoted. Accordingly, we recommend that a lender who wilfully fails to make disclosure at the stage of advertising or first inquiry should be guilty of an offence and subject to a fine of not more than $2,000.[87]

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[86] *Ibid.*, s. 4.1(b)(ii)iii.

b. Commitment Stage

Disclosure at the commitment stage is central to fulfilling the goals of full disclosure. We are of the view that the sanction for failure to comply with the proposed requirements should reflect this importance. It has been suggested that lenders should be encouraged to be vigilant in ensuring that the requirements are satisfied by providing that a security agreement should be unenforceable if disclosure has not been made.

In our opinion, however, such a sanction would be not only Draconian, but imprudent. We have been advised that the potential that a security agreement might be held to be unenforceable, if disclosure is not made upon commitment, could have serious consequences for the secondary secured loan market. In Canada, this market operates on the basis that single security agreements or blocks of agreements are often discounted to lenders and, in particular, to institutional lenders. Any sanction that would impair the security in the hands of the assignee of an agreement from the original lender could result in the restriction of the availability of capital for the land security market. Accordingly, we recommend that a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the disclosure requirements, should not affect the validity of the security agreement or any proceeding taken to enforce it. In such a case, however, the court should have the power to award compensatory damages to the borrower.[88]

We believe that a lender would ordinarily have the necessary incentive to ensure that the disclosure requirements are fulfilled if, in addition to the lender's potential liability in damages, at the time the failure to disclose is discovered the borrower were given the option to exercise the right of prepayment,[89] without payment of any compensation to the lender, and we recommend that the borrower should have such a right.[90] The borrower should be required to exercise the right of prepayment within sixty days of the time that he or she first becomes aware of the lender's non-compliance.[91]

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[87] *Ibid.*, s. 4.2(5). See, for example, *Business Practices Act*, R.S.O. 1980, c. 55, s. 17(2).

[88] Draft Act, s. 4.4(9).

[89] The right of prepayment is dealt with *supra*, ch. 6, sec. 1, and draft Act, s. 5.4.

[90] *Ibid.*, s. 4.4(7).

[91] *Ibid.*

Finally, we recommend that a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the proposed disclosure requirements, should constitute an offence punishable by a fine of not more than $2,000.[92]

c. Execution Stage

Section 11 of the *Land Registration Reform Act, 1984* creates an offence for failure to fulfil disclosure requirements at the execution stage and makes a lender liable for a fine of not more than $5,000. We believe that this sanction is sufficient to ensure compliance with the proposed disclosure requirements at this stage.

d. Default Stage

We have recommended that a lender should not be entitled to enforce his or her remedies against a borrower in default until the proposed notice of default and statement of account have been served on the borrower.[93] The borrower would then be apprised of his or her rights and the lender's remedies. We believe that this will ensure compliance with the proposed disclosure requirements on default.

3. "PLAIN LANGUAGE" REQUIREMENTS

(a) PRESENT LAW

As we have noted earlier, for many persons, particularly protected borrowers, a land security agreement is by far the most significant financial transaction that they will enter into. Nevertheless, the standard security agreement is written in technical language that is, for the most part, barely comprehensible to any person who is not legally trained.

There is no requirement under either federal or provincial legislation that land security agreements should be drafted in plain language. Prior to its amendment, the *Short Forms of Mortgages Act*[94] created a means by which a drafter of a security agreement was able to utilize certain statutory covenants that were shorter or more simplified forms of more extensive and complex standard "boilerplate" covenants. An agreement that contained a short form statutory covenant was deemed to have incorporated into it the more extended, precise legal covenant set out in the statute.

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[92] *Ibid.*, s. 4.4(10).

[93] See *supra*, this ch., sec. 2(c)(i)f.

[94] R.S.O. 1980, c. 474. Section 24 of the *Land Registration Reform Act, 1984*, *supra*, note 5, repealed s. 6 of the *Short Forms of Mortgages Act* and substituted for it a new provision that effectively renders ss. 1-5 of the latter Act inoperative with respect to new mortgages. However, we understand that mortgages continue to utilize the former statutory short form covenants and incorporate by contract the extended statutory covenants appearing in the *Short Forms of Mortgages Act*.

Although under no statutory requirement to do so, the Bank of Nova Scotia has voluntarily drafted for its use a simplified residential mortgage agreement that utilizes plain English.[95] The introduction of this simplified security agreement has been welcomed by consumer advocates.[96]

(b) DEVELOPMENTS IN OTHER JURISDICTIONS

(i) Manitoba

In its *Report on a Simplified Mortgage Form*,[97] the Manitoba Law Reform Commission expressed the view that it would be in the public interest to have a standard residential mortgage form expressed, as far as reasonably practicable, in language that could be easily understood. An examination of the standard mortgage form used in Manitoba prompted the following reaction from two members of the Commission:[98]

> The present form is a classic example of incomprehensibility. It breaks all the normal rules of communication. The sentences wander on interminably. Incredibly, one of them is more than 300 words. The clauses follow no logical sequence and are often repetitive .... The language is ponderous, confusing, and replete with redundant and mumbo-jumbo words ....

Following consultation with interested groups and individuals, the Manitoba Commission drafted a form of agreement in language that it hoped would be more easily understandable to the lay borrower, without changing the purported rights and obligations contained in the standard security agreement used in Manitoba.[99]

(ii) United States

The movement to utilize plain language in consumer transactions has been more concerted in the United States than in Canada. It has been suggested that part of the reason for that movement is the belief that the courts are more likely to interpret plain language provisions in the spirit in which such provisions were intended by both contracting parties, not just one of them.[100] Where the form and language of an agreement indicate that a provision in dispute has been read and understood by both parties, it has been said that it is more likely that the courts will enforce such a provision. The plain language movement may well reflect a growing dissatisfaction on the part of the public, consumer advocates, and the courts with agreements that put one party to a contract in an unfairly controlling position.

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[95] See *infra*, Appendix 4.

[96] Roseman, "Plain English Will Eliminate Confusion in Legal Documents", *The Globe and Mail*, Toronto (January 24, 1980).

[97] Manitoba Law Reform Commission, *Report on a Simplified Mortgage Form* (1980), at 1.

[98] *Ibid.*

[99] The simplified mortgage form is attached as Appendix 5 to this Report.

[100] Felsenfeld and Siegel, *Simplified Consumer Credit Forms* (1978), at vii.

Two basic kinds of plain language legislation exist in the United States. The first is a simple statutory declaration that plain language must be used in the drafting of certain kinds of document. An example is provided by the first portion of section 5-702(a) of the New York General Obligations Law:[101]

> 5-702. Requirements for use of plain language in consumer transactions
>
> a. Every written agreement entered into after November first, nineteen hundred seventy-eight, for the lease of space to be occupied for residential purposes, or to which a consumer is a party and the money, property or service which is the subject of the transaction is primarily for personal, family or household purposes must be:
>
> 1. Written in a clear and coherent manner using words with common and every day meanings;
>
> 2. Appropriately divided and captioned by its various sections.[102]

The second kind of requirement consists of a comprehensive set of guidelines that must be followed by the drafter of a document. An example of such an effort to structure the form of agreements in "plain language" is that found in the legislation of Connecticut.[103] Consumer contracts, which include mortgages, must be written in plain language. Such contracts are considered to be written in plain language if they meet all tests specified by the statute, including: short sentences and paragraphs; everyday words; personal pronouns or personal names; simple and active verb forms; type of readable size; contrasting ink; headings in bold face type; and layouts that separate paragraphs. In addition, the legislation requires that the agreement "be written and organized in a clear and coherent manner".

The Connecticut legislation also provides an even more complicated alternative method of satisfying the plain language requirements. To do so, any agreement must fully meet all statutory tests. The tests deal with or specify the number of words in a sentence and in a paragraph, the average and maximum number of words allowed in either a sentence or a paragraph and the average number of syllables per word, minimum type size, minimum space size, and minimum border size, the average line length, and the caption type size. The statute goes further and provides a test to determine what constitutes a word, a sentence, a syllable, a paragraph, a list, and line length for purposes of drafting.

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[101] L. 1963, c. 576, § 1, as am.

[102] Further state legislation establishing analogous obligations includes: Hawaii Rev. Stat. § 487A-1 (1976) (amended 1982); Me. Rev. Stat. Ann., tit. 10, § 1124 (1964) (amended 1985); Minn. Stat. Ann. § 325 G. 31 (West Supp. 1976); W. Va. Code § 46A-6-109 (1986); N.J. Stat. Ann. § 56:12-2 (West Supp. 1982).

[103] Conn. Gen. Stat. Ann. § 42-152 (West Supp. 1958).

(c) PROPOSALS FOR REFORM

(i) Introduction

Disclosure of information will be of little value to a borrower if it is not made in a comprehensible form. It seems clear that one important step towards the goal of full disclosure for protected borrowers is the demystification of the security agreement, in part through a requirement that plain language be utilized, not only in the disclosure statements recommended above, but also in the security agreement itself.

As a general rule, there should be no great difficulty in expressing, in plain language, much of the information that is of central importance to a borrower, whether it is contained in the disclosure statement upon commitment, or in the security agreement itself. Certain terms are unique or specific to the particular agreement, such as the identity of the borrower and the description of the secured property, as well as such matters as the principal, interest rate, amortization period, term of the agreement, and date of payment or advance. These matters can be easily described and understood in common and everyday language. This is not to say that a borrower will always understand the meaning of an interest rate, or the distinction between the term of the agreement and the amortization period. However, we believe that it is not an aim of disclosure to ensure that all borrowers understand elementary financial calculations or terms; provided, for example, that interest rates are stated clearly, in order to allow comparison between potential lenders, the goal of disclosure will be met.

Other kinds of term may be somewhat more difficult to express in plain language. Examples of such terms include prepayment and renewal provisions, due-on-sale clauses, and requirements to prepay taxes or other charges to the lender. However, while some of these terms may be unfamiliar even to an informed borrower, and will therefore require careful drafting, there should not be any insurmountable difficulty in explaining such terms in clear, plain language.

The real difficulty for lenders will arise with respect to expressing in plain language the complex and historically encrusted language of the standard "boilerplate" provisions, including the provisions regarding maintenance of the property, insurance, and, of course, remedies on default. The concern that lenders have about expressing these kinds of term in plain language is that the existing language of such standard covenants has, in effect, become a "formula", with known legal consequences. It is feared that any amendment of this familiar and hallowed language may be interpreted by the courts as conferring less of an advantage or more limited rights than the lender had contemplated and that is ostensibly assured by using traditional legal jargon. As one commentator has observed:[104]

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[104] Ritter, "Simplification of Legal Language and the Bank of Nova Scotia Plain Language Mortgage Form" (1981), 39 U.T. Fac. L. Rev. 170, at 171.

> As a type of instrument develops in this way, its language is less and less directed towards a lay audience and more towards a legal audience, including ultimately the courts. The courts will construe such established types of instrument in accordance with the appearance or non-appearance of certain formulaic expression sanctioned by previous case law as achieving a certain legal result. In so doing, the courts are reflecting a pragmatic understanding that such formulae have been inserted in the instrument by the lawyer drafting it with the expectation of achieving that result and are intended to signal to the court that such result is desired ....
>
> As is well-known, the longer established a category of legal instruments is, the more formalized the language of such instruments becomes and as the buildup of case law and statutory alterations of the applicable law increases, the language of the instrument becomes a less and less reliable guide to its actual legal effect and more and more difficult to understand without a knowledge of the hidden context of case law and statute law.

(ii) Requirement of "Plain Language"

The Commission has espoused the goal of full disclosure, at all stages, for protected borrowers. We believe that this goal necessarily requires the presentation of information in a clear and comprehensible form. Accordingly, we recommend that every security agreement and every disclosure statement provided to a protected borrower should be written in a clear and coherent manner, using words with common and everyday meanings. The clauses should be appropriately divided and captioned. Where the security agreement uses personal pronouns in referring to the lender or borrower, the second person pronoun should be used in referring to the borrower.[105] Finally, the security agreement and disclosure statement should be written in type of easily readable size.[106]

We do not believe that the obligation to use plain language should be more complex or onerous than that recommended above. In our view, specific and detailed requirements, such as those set out in the Connecticut statute described in the preceding section, are cumbersome and overly technical, and, we believe, would do little to further the goal of full and meaningful disclosure.

As we have discussed, we expect that lenders will consider their most difficult task to be the recasting of the standard "boilerplate" provisions in plain language. While we recognize the legitimacy of the concerns that lenders have expressed, we do not consider this obligation to be onerous. A number of the most important boilerplate covenants, such as those governing remedies of the lender upon the borrower's default, will already have been drafted in plain language as part of the prescribed mandatory terms that we have recommended should be included in every residential security agreement.[107] Moreover, we have drafted in plain language many other standard terms that would be contained in a residential security agreement. These terms, together with the prescribed mandatory terms proposed earlier, have been incorporated into a model plain language residential security agreement, which we have appended to this Report.[108]

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[105] While this may appear to be an insignificant issue, we believe that the simple use of "you" is an effective and direct means of making a borrower understand his or her obligations under the agreement. It also avoids the difficulty of choosing an appropriate pronoun where there is more than one borrower.

[106] Draft Act, s. 5.2(1).

We wish to emphasize that, with the exception of the prescribed mandatory terms, our model security agreement is simply intended to constitute a useful precedent for lenders. Apart from these terms, lenders would remain free to develop their own terms, provided that the proposed obligation to utilize plain language is satisfied and that those terms do not derogate from the rights and remedies provided by the *Land Security Act*.

We considered recommending that, in addition to the prescribed mandatory terms we have proposed, the regulations under the Commission's *Land Security Act* should provide short form, plain language terms that would operate to incorporate by reference more precise and detailed long form terms, also to be provided for in the regulations, as was the case in the *Short Forms of Mortgages Act*.[109]

The Commission has concluded, however, that the development of such a framework would be premature. In our view, lenders themselves are best able to develop the terms that would satisfy their plain language obligations, as well as protect their legitimate interests respecting both residential and non-residential security agreements. Accordingly, some time should be allowed for the market to generate such terms. However, the desirability of a scheme similar to that of the *Short Forms of Mortgages Act* should be reviewed by the Land Security Committee, which we shall recommend below, after the Act has been in force for five years, and we so recommend.

(iii) The Effect of Non-Compliance

The Commission anticipates that lenders will want to comply voluntarily with the proposed plain language requirements, since the failure to use a plain language security agreement may well leave them at a competitive disadvantage in the residential loan market.

Nevertheless, we believe that some further sanction is in order for non-compliance. Accordingly, we recommend that a lender should be liable to a fine of not more than $2,000 for breach of these requirements.[110] Such a breach should not, however, have any effect on the validity or enforceability of the security agreement.[111]

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[107] See *supra*, this ch., sec. 2(c)(i)e.

[108] See *infra*, Appendix 7.

[109] *Supra*, note 94.

[110] Draft Act, s. 5.2(2).

[111] *Ibid.*, s. 5.2(3).

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The recommendations respecting disclosure at the advertising or first inquiry stage and at the commitment stage (see Recommendations 2-6) should apply only where the prospective borrower is a protected borrower.

2. (1) At the advertising or first inquiry stage, any representation by or on behalf of a lender of the rate to be charged on a loan secured by land should disclose the cost of borrowing, expressed as an annual percentage rate or range of rates applicable to the class of loan being advertised, and the nature, but not necessarily the amount, of other expenses not included in the cost of borrowing, that must be paid by the protected borrower.

   (2) The disclosure requirement proposed in paragraph (1) should apply whether the representation is made in response to an oral or written inquiry or in an advertisement.

3. A lender should be free to disclose information or explanations additional to that contained in any advertisement or statement, if the additional information or explanation is not stated, utilized, or placed so as to contradict, obscure, or distract attention from the information required to be disclosed.

4. A lender should not be bound to enter into a security agreement with the borrower that conforms with the lender's representations under Recommendation 2(1) by reason only that the lender has made disclosure in compliance with the above recommendations.

5. (1) In order to ensure that a prospective protected borrower is capable of making informed comparisons between lenders, a list of suggested questions that the borrower might ask a lender should be prepared by the proposed permanent specialized ministerial committee dealing with security matters (see chapter 11, Recommendation 4).

   (2) The list should specifically address those features of a security agreement with which many borrowers might not be familiar, such as rights of prepayment or due-on-sale clauses, and optional terms, such as renewal rights, and the relative costs of these features or terms.

   (3) The list should be made widely available through libraries, real estate offices, and in such other ways as consumer information is now made available about such matters as home insulation, home security, and public health.

(4) A lender upon whom there is an obligation to disclose should be required to make the proposed information questionnaires in the prescribed form available to prospective borrowers at the lender's places of business, at no cost to the borrower, and to give a copy of the information questionnaire to the borrower at the lender's first opportunity.

6. (1) At the commitment stage, the lender should be required to provide a protected borrower with a disclosure statement in a prescribed form that would contain information of the type that satisfies the existing requirements of Schedule II of the regulations under the *Bank Act*, but modified to provide information with respect to price level adjustment agreements and shared appreciation agreements.

(2) The proposed disclosure statement should be given to the protected borrower at the time when the lender communicates to the borrower the terms on which the lender offers to take security from the borrower, but in any event not less than five days before the borrower is required to accept the offer. However, subject to the terms of the disclosure statement, the borrower should remain free to accept the commitment offer at any time after receiving the disclosure statement.

(3) Where the terms of the offer specified in the commitment letter differ from those specified in the disclosure statement, the terms of the disclosure statement should govern.

7. The recommendations respecting disclosure at the execution stage (see Recommendation 8) should apply in all cases, whether or not the borrower is a protected borrower.

8. (1) On or before the date when the borrower signs the *Land Registration Reform Act, 1984* charge in Form 2, the lender should be required to give to the borrower a copy of the security agreement, where it is appended as a schedule to Form 2, or a copy of the standard terms filed by the lender with the Director of Land Registration.

(2) In the event of any discrepancy between the terms of the disclosure statement upon commitment and the security agreement, the following rules should apply:

(a) as between the parties, the individual terms of each document most beneficial to the borrower should prevail; and

(b) the terms of the security agreement should govern the rights of all other persons.

9. (1) Every residential security agreement should contain terms, prescribed by regulation, that disclose certain rights, obligations, and remedies of a lender and a protected borrower that are not subject to waiver or abridgement prior to default.

   (2) The prescribed mandatory terms should be inserted in the residential security agreement under the caption to which the subject matter of each individual term relates. The lender should be entitled to integrate the mandatory terms with other provisions in the agreement, provided that such integration does not contradict, obscure, or distract attention from the substance of the terms. Similarly, the lender should be entitled to alter the mandatory terms where the security agreement uses pronouns or other descriptions in referring to the lender, borrower, or agreement that differ from those used in the mandatory terms.

   (3) Section 7(1) and (5) of the *Land Registration Reform Act, 1984* should be repealed.

10. Prior to exercising any remedy against a borrower in default, whether or not he or she is a protected borrower, the lender should be required to serve the borrower with a notice of default in prescribed form, together with a statement of account showing the amount outstanding on the loan and the payment required to put the security agreement in good standing, as of the date the lender intends to commence further proceedings to enforce the security agreement.

11. The notice of default and statement of account should be served not less than ten business days after default has first occurred under the security agreement.

12. The notice of default should be in writing and should set out, in plain language (see Recommendation 16), the default or defaults under the security agreement, the rights and remedies of the lender and the borrower on default, and such other information as may be prescribed.

13. (1) For the purpose of subjecting lenders to the disclosure requirements, and subject to the exceptions proposed in paragraph (2), the term "lender" should be broadly defined to include, for example, any person who lends money on the security of land and any person who acts for either the borrower or the lender in arranging a loan on the security of land. The disclosure requirements should be imposed on such persons as real estate agents or solicitors if they are performing a function similar to that of a mortgage broker, but not if they are merely facilitating the loan transaction by preparing the relevant documentation.

   (2) An exemption from the disclosure requirements at the advertising or first inquiry stage and at the commitment stage should be created with respect to:

(a) a vendor take-back security agreement, where the vendor would be a protected borrower if he or she sought financing on the security of the land purchased;

(b) a security agreement involving a related lender; and

(c) an agreement that secures a loan, in an amount prescribed by regulation, by a non-professional lender who, each year, makes no more than two loans secured by an interest in land.

14. A lender who wilfully fails to make disclosure at the advertising or first inquiry stage should be guilty of an offence and subject to a fine of not more than $2,000.

15. (1) Where, at the commitment stage, there is a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the disclosure requirements, the validity of the security agreement, or any proceeding taken to enforce it, should not be affected. In such a case, however, the court should have the power to award compensatory damages to the borrower.

(2) Where the lender fails to comply with the disclosure requirements at the commitment stage:

(a) in addition to the lender's potential liability in damages, at the time that such failure is discovered, the protected borrower should be entitled to exercise the right of prepayment, without payment of any compensation to the lender; and

(b) the borrower should be required to exercise the right of prepayment within sixty days of the time that he or she first becomes aware of the lender's non-compliance.

(3) Where there is a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the proposed disclosure requirements at the commitment stage, the lender should be guilty of an offence punishable by a fine of not more than $2,000.

16. (1) All disclosure statements given to a protected borrower, as well as the security agreement itself, should be subject to a "plain language" requirement. That is, every security agreement and every disclosure statement provided to a protected borrower should be written in a clear and coherent manner, using words with common and everyday meanings. The clauses should be appropriately divided and captioned. Where the security agreement uses personal pronouns in referring to the lender or borrower, the second person pronoun should be used in referring to the borrower. Finally, the security agreement and disclosure statement should be written in type of easily readable size.

(2) The lender should be liable to a fine of not more than $2,000 for breach of the plain language requirements, but such a breach should not have any effect on the validity or enforceability of the security agreement.

17. Regulations under the proposed *Land Security Act* should not, at this time, provide short form, plain language covenants that would operate to incorporate by reference more precise and detailed long form covenants. Rather, with respect to terms other than the prescribed mandatory terms proposed in Recommendation 9, lenders should be left to develop the terms that would satisfy their plain language obligations, as well as protect their interests respecting both residential and non-residential security agreements. However, the desirability of a scheme similar to that of the *Short Forms of Mortgages Act* should be reviewed by the proposed Land Security Committee (see chapter 11, Recommendation 4), after the Act has been in force for five years.

CHAPTER 8

REALIZATION OF THE SECURITY: POWER OF SALE AND FORECLOSURE

1. REMEDIES UPON A BORROWER'S DEFAULT: A GENERAL INTRODUCTION

Since a mortgage is security for a debt due, the ultimate purpose of mortgage remedies is the collection of that debt. In Ontario, a lender currently has a variety of contractual and statutory remedies from which to choose in order to achieve this end, including an action on the borrower's personal covenant for payment of the debt, taking possession of the secured property, appointment of a receiver, sale of the property, either by contractual power of sale or court-supervised sale, and foreclosure. These remedies may be sought concurrently, so far as they are not inconsistent with one another.

The development of mortgage remedies has been a process by which equity has sought to balance the legitimate interests and expectations of both lenders and borrowers. This development has been shaped by the effect of the separate and often competing jurisdictions of the Court of Chancery and the common law courts in England and, later, in Ontario.

Prior to the fusion of both legal and equitable jurisdiction in one court,[1] an action for payment of the mortgage debt had to be pursued in the courts of common law, while the remedies relating to the real property secured could be obtained only in the Court of Chancery. Legal and equitable remedies could be pursued at the same time, but in separate actions.

An understanding of the current state of the law of mortgages must necessarily involve an historical review of the development of remedies arising from the original divided jurisdiction of the Court of Chancery and the common law courts.[2] We begin, in the remaining portion of this chapter, with the remedies of foreclosure and sale. We then turn to a discussion of actions on the covenant and rights of possession, in chapters 9 and 10, respectively.

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[1] In Ontario, see *Judicature Act*, R.S.O. 1881, c. 5.

[2] Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 411 *et seq.*

2. HISTORICAL DEVELOPMENT OF REDEMPTION, FORECLOSURE, AND SALE

(a) THE RIGHT OF REDEMPTION, FORECLOSURE, AND JUDICIAL SALE

Prior to the intervention of equity, a mortgage was merely a contract for a loan and a transfer of title in the land to the lender as security for that loan. The lender's title to the land was defeasible upon performance of a condition subsequent, most commonly the repayment of the debt on a specified date. If the borrower defaulted in performance of the condition subsequent, the borrower irrevocably forfeited his or her right to require reconveyance of the title from the lender.

The common law courts were strict in their application of contractual principles when they construed the terms of a mortgage. They would not admit of any right of the borrower to redeem the property beyond what was actually stipulated in the mortgage contract,[3] and that right was typically very restricted. As a result of such a literal interpretation of the contractual terms, the idea that title was transferred merely to secure a debt — a notion to which the common law courts paid lip service[4] — was obscured until equity intervened to mitigate the harshness of the common law. The product of equity's intervention is the "elaborate superstructure" of the present law of mortgages.[5]

Equity first moved against lenders in the sixteenth and early seventeenth centuries. Its purpose was to grant relief to borrowers in special circumstances, such as where the borrower's default occurred as a result of accident or fraud,[6] or in instances of harsh or unconscionable treatment on the part of the lender. Eventually, during the period from 1615 to 1630, the borrower's right to redeem the property, or "equity of redemption", crystallized from what might be called an equitable favour into a vested right to redeem, that is, a right to pay the mortgage debt and compel reconveyance of the legal title. Moreover, this equity of redemption itself became an estate in land capable of being encumbered and conveyed.[7]

By the creation of this right, equity had, then, effectively imposed obligations on the lender that were not in accordance with the language of the contract. In so doing, equity carried almost to its logical conclusion the principle that the mortgage transaction was, in essence, the granting of security for a debt.

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[3] Holdsworth, *History of English Law* (3d ed., 1945, rep. 1966), Vol. 2, at 579.

[4] *Ibid.*

[5] *Ibid.*, Vol. 3, at 129-30.

[6] Falconbridge, *supra*, note 2, at 41, citing *Courtman v. Conyers* (1600), Acta Cancellariae 764, and Holdsworth, *supra*, note 3, Vol. 5, at 331.

[7] *Lord Nottingham's Chancery Cases*, Vol. II, Seldon Society, Vol. 79 (1961), at 31-32, citing *Emmanuel College v. Evans* (1625), 1 Ch. Rep. 18.

The borrower's right of redemption was limited only by a general requirement that the application for relief had to be made within a reasonable period of time. As a result, the property remained subject to an outstanding right of redemption for some time. The consequent uncertainty respecting legal title to property could affect the sale price adversely, thereby undermining the legitimate expectations of the lender or a purchaser.

Thus, the creation of an equitable right of redemption in favour of the borrower necessitated, for equity, the creation of a correlative right in the lender to apply to the court to extinguish, or foreclose, the borrower's equity of redemption.[8] An application for foreclosure allowed a lender to force a defaulting borrower to exercise the right of redemption within a specified time or be barred forever from so doing. In the latter case, the lender was left with undisputed title in both equity and law.[9]

Occasionally, borrowers would be unable to pay the mortgage debt and compel the reconveyance of legal title, thereby avoiding foreclosure. The value of the property often exceeded the amount of the debt due. In such a case, foreclosure would result in a windfall to the lender. Accordingly, the remedy of a court-supervised sale developed as an alternative to foreclosure.[10] By requiring a judicial sale of the property, the Court of Chancery could ensure that the lender's debt was satisfied and that any surplus from the sale would be distributed among subsequent encumbrancers, according to their priority. Any residue, after payment to all encumbrancers, could then be paid to the borrower. The scrutiny of the court was intended to ensure that a fair price was obtained from the sale and that the borrower's recovery, and, indeed, the recovery of all parties, was maximized.

(b) THE CONTRACTUAL POWER OF SALE

The development by equity of the right to redeem, and the remedies of foreclosure and judicial sale, achieved a fair balancing of the competing interests of lenders and borrowers. However, insofar as these two remedies were concerned, this development also spawned a complex and often time-consuming procedure, fraught with technical traps and procedural delays. In order to secure a more expeditious disposition of the property and recovery of the debt, lenders began to include in their mortgage contracts a term providing for a private power of sale that was exercisable by the lender upon the borrower's default. This contractual power of sale allowed for a disposition of the property without resort to judicial proceedings.

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[8] *How v. Vigures* (1628-9), 1 Ch. R. 32, 21 E.R. 499; Holdsworth, *supra*, note 3, Vol. 5, at 331-32; and Turner, *The Equity of Redemption* (1931), at 28.

[9] Subject to an application to reopen the final order of foreclosure: see *infra*, this ch., sec. 3(a)(v).

[10] The equitable jurisdiction of the Court of Chancery to order judicial sale was exercised only in special circumstances prior to 1852. The *Chancery Procedure Amendment Act, 1852*, 15 & 16 Vict., c. 86 (U.K.), created a general statutory authority to order judicial sale.

The contractual power of sale was used as early as the eighteenth century. However, there was initial uncertainty regarding the validity of such a power. The Court of Chancery viewed its use as contrary to the protections that it had created for the borrower.[11] Nevertheless, by the early nineteenth century, the legitimacy of the contractual power of sale had been confirmed and, indeed, the power soon became regarded as a necessary incident to a mortgage.[12] By the late nineteenth century, a statutory implied power of sale had been created.[13]

3. PRESENT LAW

As we have said, resort by lenders to the contractual power of sale is largely explained by the existence of complex procedures for both foreclosure and judicial sale, as well as by the comparatively protracted time frames involved in the exercise of these two remedies. Lenders have attempted to circumvent the technical, procedural hurdles that borrowers and subsequent encumbrancers can erect, sometimes merely in order to delay realization of the security, by providing for an extra-judicial, contractual power of sale.

Compared to foreclosure and judicial sale, the remedy of extra-judicial sale does provide an expeditious and inexpensive method of disposing of the property and recovering the debt. However, as we shall see, the use of the latter remedy is not without its share of difficulties. Borrowers are still able to erect some procedural barriers to delay a sale. Moreover, given the fact that the lender is also seeking possession of the secured property, there may well be further impediments created in the course of obtaining a writ of possession from the court.

We turn now to a brief description of the respective procedural requirements of foreclosure and judicial and contractual power of sale, for such a description will illustrate clearly the practical rationale for the choice of the latter remedy by lenders. It also provides the essential background in respect of the Commission's recommendations in this chapter.

(a) FORECLOSURE

(i) Joinder of Parties

A lender's first task in a foreclosure action is to determine who are the proper parties to the proceedings and how such parties should be joined.

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[11] There was some concern that such an express power constituted a clog on the equity of redemption. See Turner, *supra*, note 8, at 179. With respect to clogs on the equity of redemption, see *supra*, ch. 3, sec. 3.

[12] Falconbridge, *supra*, note 2, at 702, and *The King v. The Parish of Edington* (1801), 1 East 288, 102 E.R. 112 (K.B.).

[13] *Lord Cranworth's Act*, 23 & 24 Vict., c. 145 (U.K.). In Ontario, see *An Act to give to Mortgagees certain powers now commonly inserted in Mortgages*, 42 Vict., c. 20. See, now, s. 23.1 of the *Mortgages Act*, R.S.O. 1980, c. 296.

In an action for foreclosure, all persons having an interest in the equity of redemption must be joined as defendants.[14] Such persons include all subsequent encumbrancers (subject to an exception, discussed below),[15] a transferee of the property, if the original borrower has sold the property, lessees, trustees in bankruptcy of the mortgagor, execution creditors, and construction lien claimants.[16] Section 22(1) of the *Family Law Act, 1986*[17] also provides that a spouse who has a right of possession[18] of a matrimonial home[19] has the same right of redemption as the borrower, and is entitled to any notice the borrower is entitled to receive respecting any enforcement or realization of a lender's right or interest in the property. Accordingly, a lender is under an obligation to make reasonable inquiries into the marital status of the borrower before initiating foreclosure proceedings. Failure to join a spouse can result in a judgment that does not bind that spouse.[20]

Where it is expedient, a plaintiff may commence proceedings without naming subsequent encumbrancers, although he or she may make a motion on a reference after judgment to add subsequent encumbrancers.[21] Such an application is generally made in matters involving large numbers of persons or complicated priorities.[22] However, a plaintiff must exercise such an option with care, since he or she may be deprived of costs on the reference where the referee considers that such subsequent encumbrancers should have been named as defendants in the statement of claim.[23]

(ii) Initiating Foreclosure Proceedings

Foreclosure proceedings are initiated by a statement of claim in Form 14B, prescribed by the Rules of Civil Procedure.[24] Care must be taken with this as with other formal requirements. Under the former Rules of Practice,[25] a failure to comply with these requirements resulted in a refusal to sign judgment[26] or in the judgment being set aside at a later date.[27] The ultimate recovery was almost invariably diminished as a result of the delay. The new Rules of Civil Procedure have a general relieving provision for non-compliance with the Rules, or for irregularity in a proceeding, that may lessen this concern.[28] It remains to be seen how this provision, which attempts to abolish the concept of procedural nullities, will be applied by the courts.

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[14] Rules of Civil Procedure, O.Reg. 560/84, r. 64.03(1). (Unless otherwise noted, subsequent references to a particular "Rule" refer to the Rules of Civil Procedure.)

[15] Rule 64.03(2). See text accompanying notes 21-23, *infra*.

[16] Marriott and Dunn, *Practice in Mortgage Actions in Ontario* (4th ed., 1982), at 25-53.

[17] *Family Law Act, 1986*, S.O. 1986, c. 4.

[18] *Ibid.*, s. 19.

[19] *Ibid.*, ss. 18 and 20.

[20] *Maritime Life Assurance Co. v. Karapatakis* (1979), 24 O.R. (2d) 311, 7 R.P.R. 229 (Master S.C.O.).

[21] Rule 64.03(2).

[22] Marriott and Dunn, *supra*, note 16, at 42.

[23] Rule 64.03(3).

[24] Rule 64.03(4).

[25] Rules of Practice, R.R.O. 1980, Reg. 540.

[26] *Elliott v. Byers* (1917), 13 O.W.N. 107 (App. Div.).

All defendants must be served with a statement of claim. Delays and mounting costs can result where a defendant is difficult to locate or is evading service. In such a case, a lender may be required to make an application for substituted service.[29]

(iii) Exercising the Right to Redeem and Raising a Defence

It is very unlikely that the lender will obtain an order of foreclosure immediately. The owner of the property, the original borrower (if he or she has transferred the property), and all subsequent encumbrancers have available to them a variety of responses to the lender's statement of claim.

Upon service of the statement of claim, a defendant is entitled to file a request to redeem,[30] a request for sale,[31] or a statement of defence.[32] Some of the possible defences in a foreclosure action include allegations of fraud in the original mortgage transaction, a denial of default, or claims of unconscionability, inequality of bargaining power, or *non est factum*.[33] The defendants may also dispute the amount claimed, plead a set-off, or raise a counterclaim against the lender.

If the defence amounts only to a dispute as to the amount owing, the lender may bring a motion for judgment or to cross-examine the deponent on his or her affidavit where the lender believes there is no merit to the defence.[34] Similarly, a lender may bring an application to have a counterclaim struck out where the claim is doubtful or appears to be made for the purpose of delay;[35] where the lender is successful, the defendant will be forced to bring a separate action in respect of that claim.[36]

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[27] *Martin v. Evans* (1917), 39 O.L.R. 479, 37 D.L.R. 376 (App. Div.).

[28] Rule 2.01(1) provides that "[a] failure to comply with these rules is an irregularity and does not render a proceeding or a step, document or order in a proceeding a nullity...". The court is given the power, *inter alia*, to grant an amendment or other relief, or, where necessary, to set aside the proceeding or step, document, or order.

[29] Rule 16.04.

[30] Rule 64.03(6).

[31] Rule 64.03(17), (18), and (19).

[32] Rule 18.01.

[33] Marriott and Dunn, *supra*, note 16, at 58.

[34] Rules 20 and 39.02.

[35] Rule 20.09 makes the rules for summary judgment (R. 20) applicable to counterclaims.

Typically, upon service of the lender's statement of claim, one or all of the defendants will file a request to redeem,[37] even if there is no possibility of reinstating the mortgage or redeeming the secured property. Under the Rules of Civil Procedure, the standard redemption period, after the taking of accounts by the lender, has been reduced from six months, which was the time frame under the former Rules of Practice,[38] to sixty days.[39] This redemption period starts to run when the mortgage accounts are formally established on a reference. Aside from the fact that it often takes some time to have the matter heard on a reference, and that a reference may be adjourned, delays in the commencement of the redemption period can be expected in cases where the accounts are disputed. Disputed issues may include the validity and method of computing interest, bonuses, and allowances, the calculation of occupation rent where the lender has gone into possession of the secured property, and the accounting by a lender in possession for rents or crops.[40]

(iv) Abridgement and Extension of the Redemption Period

While the Rules of Civil Procedure provide for a standard redemption period of sixty days after the taking of accounts, the period may be either extended or abridged at the court's discretion.[41] We are not aware of any cases decided under this Rule.

Abridgement of the redemption period under the former Rules of Practice[42] was allowed either by consent of all parties or in cases where the value of the property might depreciate, to the detriment of one or more of the parties to the action. However, in the absence of consent, immediate foreclosure was rarely allowed and, where it was allowed, only where it was proved that the value of the property was less than the mortgage debt outstanding.[43]

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[36] *Greisman v. Blake* (1927), 33 O.W.N. 197 (H.C. Div.); *Odell v. Bennett* (1889), 13 P.R. 10 (H.C.J.); and *Higgins v. McLachlan* (1881), R.E.D. 441 (C.A.).

[37] Rule 64.03(6).

[38] *Supra*, note 25, r. 466(3).

[39] Rule 64.03(8). The "taking of accounts" is a determination of the amount of principal, interest, bonuses, costs, and expenses that is owed by the borrower to the lender.

[40] See, generally, Marriott and Dunn, *supra*, note 16, at 101-28.

[41] Rule 64.06(27).

[42] *Supra*, note 25, r. 495(3).

[43] Marriott and Dunn, *supra*, note 16, at 163-64, citing *The Bucks & Oxon Union Bank v. Hill*; *Elkington v. Willett* (1935), 49 B.C.R. 325 (S.C.); *Anglican Synod v. Russell and May* (1927), 38 B.C.R. 400 (S.C.); *Croxon v. Lever* (1863), 9 L.T. 597, 12 W.R. 237 (Rolls); *Bennett v. Harfoot* (1871), 24 L.T. 86, 19 W.R. 428 (V.C. Stuart's Ct.); and *Wolverhampton and Staffordshire Banking Co. v. George* (1883), 24 Ch. D. 707.

Although, under the former Rules of Practice, an extension of the time to redeem was not granted as a matter of course,[44] the applicant did not need a very compelling reason for failing to redeem within the standard period of time in order to succeed.[45] The usual extension of the time to redeem was for a further six months, and still more time could be given even after such an extension.[46] In one case, up to four extensions were granted, notwithstanding the fact that a term of the third order was that there were to be no more extensions.[47]

(v) Opening a Final Order of Foreclosure

The potential for repeated extensions of the redemption period is not the only uncertainty that the lender faces in a foreclosure action. Even upon obtaining a final order of foreclosure, which is ostensibly absolute, a lender may be required to meet a claim by a person having an interest in the equity of redemption, including even a purchaser for value,[48] to have the final order set aside on equitable grounds. A final order of foreclosure may also be set aside for irregularities. In one case, the irregularity was discovered twenty years after the issuance of the final order.[49]

(vi) Other Procedural Matters

The foreclosure procedure entails many other steps, including such matters as settling, filing, and service of the referee's report, appeals from that report, notification to all parties affected of any change of account from the original judgment (such as where the lender pays an outstanding tax debt), addition of parties, and settlement of disputed priorities on a reference. Each of these matters involves notice requirements, delay periods for response, and, often, a further appearance before the referee.

(b) JUDICIAL SALE PROCEDURE

The procedure developed for judicial sale also involves complex requirements designed to safeguard the interests of borrowers, transferees, and subsequent encumbrancers.[50] Judicial sale can arise in several ways. The lender can choose to initiate judicial sale proceedings rather than foreclosure proceedings. More commonly, a judicial sale arises by virtue of the filing of a request for sale by a defendant, other than a subsequent encumbrancer, in a foreclosure proceeding.[51] Finally, the referee, on the motion of any party, has the power to direct a sale, at any time, where it is considered to be in the best interests of the parties.[52]

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[44] *Kerbel v. Clayton*, [1952] O.W.N. 410 (C.A.). See, also, *Eyre v. Hanson* (1840), 2 Beav. 478, 48 E.R. 1266 (Rolls), and *Quarles v. Knight* (1820), 8 Price 630, 146 E.R. 1318 (Exch.).

[45] Marriott and Dunn, *supra*, note 16, at 159, citing *Nanny v. Edwards* (1827), 4 Russ. 124, 38 E.R. 752 (Ch.).

[46] *Eyre v. Hanson*, *supra*, note 44, cited in Marriott and Dunn, *supra*, note 16, at 162.

[47] *Edwards v. Cunliffe* (1816), 1 Madd. 287, 56 E.R. 100 (V-C's Ct.), cited in Marriott and Dunn, *supra*, note 16, at 162.

[48] *Dovercourt Land Building and Savings Co. v. Dunvegan Heights Land Co.* (1920), 47 O.L.R. 105 (H.C. Div.), at 108, and *Zinck v. Lobster Point Realty Corp.*, [1952] 2 D.L.R. 359 (N.S.S.C., App. Div.).

[49] *Martin v. Evans*, *supra*, note 27. With respect to the effect of R. 2 of the new Rules of Civil Procedure on irregularities, see *supra*, note 28, and accompanying text.

The sale proceedings are subject to the scrutiny of the referee.[53] On the reference in respect of the sale, the plaintiff is required to file "sufficient evidence" as to title and encumbrances, including such information as a registrar's abstract of title, a sheriff's certificate respecting executions, and a bankruptcy certificate, so that the referee can be assured that all necessary parties are joined in order to give a purchaser good title.[54] When all the necessary material has been filed, the referee will appoint a time to consider and settle the conditions and conduct of sale. The lender must notify all parties of the appointment.[55]

At the reference, the referee will determine the party who will have conduct of the sale, the timing of the sale, the place, manner, and method of sale, advertising requirements, and the appraisal or valuation of the property.[56] If the sale is by auction, the referee may name an auctioneer and fix a reserve bid. The referee has the power to make any other arrangements necessary for the sale.

Upon a sale, the purchaser must pay the purchase money directly into court, unless the referee directs otherwise.[57] After confirmation of the referee's report on the sale,[58] and on giving notice to the party having carriage of the sale, the purchaser may obtain an order that vests title of the property in him or her.[59]

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[50] The procedure for judicial sale is set out in r. 64.04 of the Rules of Civil Procedure, *supra*, note 14.

[51] Rule 64.03(17).

[52] Rule 64.03(22).

[53] Rule 64.04(12).

[54] Rule 64.06(2).

[55] Rule 64.06(8).

[56] Rule 55.06.

[57] Rule 64.04(12).

[58] Rules 54.06-54.08. The report on the reference is confirmed on a motion by the judge who directed the reference, upon notice to every party who appeared on the reference.

[59] Rule 55.06(12).

This transfer is, however, subject to the referee's approval. Approval will not be given until the referee is satisfied that the purchase money has been paid into court and, where a mortgage has been taken for part of the purchase money, that the mortgage has been registered and deposited with the registrar of the court.[60]

Where a foreclosure action has been converted into a sale action, the referee, on the motion of any party, may reconvert the sale to a foreclosure "where it appears that the value of the property is unlikely to be sufficient to satisfy the claim of the plaintiff".[61] All defendants are once again entitled to redeem. In such a case, the usual redemption period is thirty days,[62] although the court may extend or abridge the time for redemption.[63]

(c) CONTRACTUAL POWER OF SALE

(i) Introduction

Prior to statutory intervention, the exercise of the lender's power of sale was strictly a contractual matter. The form of the sale and the rights of the parties, including any entitlement to receive notice of an intention to exercise the power of sale upon default by the borrower, were determined by negotiation and agreement between the borrower and lender. Accordingly, if the mortgage so provided, the lender could exercise the power and sell the property without notice to the borrower.[64] However, such a power to sell without notice had to be expressed clearly in the mortgage.[65]

In the nineteenth century, when the contractual power of sale came to be regarded as a necessary incident to a mortgage, an implied contractual power of sale was created by statute.[66] However, the exercise by the lender of this new statutory power was subject to an obligation on the part of the lender to give prior notice to those persons having an interest in the property. In 1964, *The Mortgages Act* of Ontario was amended to extend this obligation to give notice of the exercise of an express contractual power of sale.[67]

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[60] Rule 55.[illegible](15).

[61] Rule 64.03(23).

[62] Rule 64.06(26).

[63] See the closing flush of r. 64.06(26) and, as well, r. 64.06(27).

[64] *Re British Canadian Loan and Investment Co. and Ray* (1888), 16 O.R. 15 (H.C.J.); *Clark v. Harvey* (1888), 16 O.R. 159 (H.C.J.); and *Barry v. Anderson* (1891), 18 O.A.R. 247.

[65] *Re Cotter* (1903), 14 Man. R. 485 (K.B.), and *Dominion Trust Co. v. Bower* (1906), 3 W.L.R. 157 (B.C.S.C.).

[66] See *supra*, note 13.

[67] *The Mortgages Amendment Act, 1964*, S.O. 1964, c. 64, s. 5, adding a new Part II-A to the Act. See, now, Part III of the *Mortgages Act*, *supra*, note 13.

Prior to the amendment of the *Short Forms of Mortgages Act*,[68] the ordinary practice in Ontario was to use the express power of sale provided by that Act. This power could be modified to suit the parties, since section 3(3) of the *Short Forms of Mortgages Act* provided that the parties could introduce into, or annex to, any of the short forms any express exceptions or qualifications. The statutory power of sale, discussed in the preceding paragraph, would not be implied if an express power had been included in the mortgage, or if the statutory power of sale had been expressly excluded.[69]

While it is no longer possible to utilize the *Short Forms of Mortgages Act* in this way,[70] it appears that the general practice is to continue to refer to the statutory power of sale and incorporate this power into the mortgage by means of express contractual terms.

(ii) Notice Requirements

The close scrutiny of the court and the intricacies of the reference procedure where foreclosure or judicial sale are involved are avoided through the exercise of the express or statutorily implied contractual (that is, extra-judicial) power of sale. In place of the control and review of the conduct and manner of sale by the court, the lender's exercise of the contractual power of sale is subject to certain statutory notice obligations prior to sale, and to minimum standards in the conduct of the sale that have been developed by equity and the common law.

Compared to foreclosure and judicial sale, the procedural requirements that must be satisfied prior to the exercise of a contractual power of sale are minimal. The *Mortgages Act* requires the lender to give notice of an intention to exercise the power of sale to persons having an interest in the property.[71] Those persons include subsequent encumbrancers, statutory lien holders, execution creditors,[72] and any other person who has actually notified the lender in writing that he or she has an interest in the property.

As in the case of foreclosure and judicial sale, section 22(1) of the *Family Law Act, 1986*[73] requires that, where a lender wishes "to realize upon ... [an]

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[68] R.S.O. 1980, c. 474, Schedule B, para. 13. The Act was amended by the *Land Registration Reform Act, 1984*, S.O. 1984, c. 32, s. 24. This section repealed s. 6 of the principal Act and substituted a new provision that, in effect, renders the *Short Forms of Mortgages Act* inapplicable to future mortgages in Ontario.

[69] *Mortgages Act*, *supra*, note 13, s. 29.

[70] See the reference to the effect of the amending legislation, *supra*, note 68.

[71] *Mortgages Act*, *supra*, note 13, s. 30(1).

[72] Execution creditors are entitled to notice if they have filed a writ of execution with the sheriff prior to notice being given to all other persons, pursuant to s. 30 of the *Mortgages Act*: *Re Morra and Aloe*, [1971] 2 O.R. 532 (H.C.J.).

[73] *Supra*, note 17.

encumbrance", notice must also be given to the borrower's "spouse"[74] if the secured property is a "matrimonial home"[75] within the meaning of the Act.[76]

The length of the delay period prior to the exercise of the contractual power of sale depends on whether the power of sale is express or is implied by statute.[77] In the case of an express power of sale, the delay period is thirty-five days from the giving of notice,[78] while in the case of the implied statutory power, the delay is forty-five days.[79] In either case, notice may not be given until the default has continued for fifteen days.[80]

If a mortgage is payable upon demand, default does not occur until a demand is actually made on the borrower. Notice of an intention to exercise a power of sale has been held to be a demand.[81] However, as indicated, in order to comply with the *Mortgages Act*, the default must continue for at least fifteen days. Accordingly, a further notice of an intention to exercise the power would have to be served following the fifteen day delay period.

The notice of intention to exercise the power of sale need not be served personally. Section 32 of the *Mortgages Act* provides for either personal service or service by registered mail addressed to the person to whom it is to be given, either at the usual or last known address or at the place or address given on the registered instrument.[82] The parties may expressly provide in the mortgage for personal service or service at a specified address. Section 32 makes specific provision for service on execution creditors, construction lien claimants, persons under disabilities, and the estates of deceased persons. Notice must be given in the form prescribed by the Act.[83]

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[74] *Ibid.*, s. 1.

[75] *Ibid.*, ss. 18 and 20.

[76] *Ibid.*, s. 22(1). See discussion *supra*, at text accompanying notes 17-20.

[77] See discussion *supra*, this ch., sec. 3(c)(i).

[78] *Mortgages Act*, *supra*, note 13, s. 31.

[79] *Ibid.*, s. 25.

[80] *Ibid.*, ss. 25(2) and 31.

[81] *Re Sovereign Bank and Keilty* (1910), 1 O.W.N. 456 (H.C.J.), and *Rogers v. Mutton* (1862), 7 H. & N. 733, 158 E.R. 664 (Exch.).

[82] Section 33 of the Act deems service to have been given on the day on which the notice is mailed by registered mail. By contrast, under the Rules of Civil Procedure, *supra*, note 14, r. 16.03(4) provides that service by mail to the last known address is effective only if the acknowledgment of a receipt card, or post office receipt, bears a signature that purports to be that of the person to be served. The date of service is the date on which the lender receives such a receipt back from the post office. While service by mail under the *Family Law Act, 1986*, *supra*, note 17, s. 22(2), is deemed to be effective on the fifth day after mailing, s. 22(3) provides that, "[w]hen a person exercises a power of sale against property that is a matrimonial home, sections 32 and 33 of the *Mortgages Act* apply and subsection (2) does not apply". The rule in s. 22(3) is also the general rule for service by mail under r. 16.06(2) of the Rules of Civil Procedure, other than for service to the last known address under r. 16.03(4), described above.

The notice and delay periods in respect of both express and statutorily implied powers of sale are minimum requirements that apply notwithstanding any agreement to the contrary between the parties.[84] The parties remain free to expand the requirements by agreement. However, the court has a discretion to modify or dispense with the notice requirements where circumstances warrant.[85] An application to the court for this purpose must be supported by evidence justifying what would amount to a serious curtailment of the borrower's and encumbrancer's rights.[86]

The exercise of the power of sale is considered a self-help measure, with serious consequences for all persons having an interest in the property. Accordingly, the courts have required strict compliance with both the form of the notice and the method of service.[87] Unless the details of Form 1, under the *Mortgages Act*, are complete and accurate, the notice will be considered a nullity. Failure to state the amount of principal, interest, and costs, or to include the signature of the lender or his or her agent, has been held to be fatal to sale proceedings.[88]

The rationale for this requirement of strict compliance appears to be that a properly completed and signed notice alerts the recipient to the fact that there has been personal authorization and approval by the lender of both the form and content of the notice, thereby emphasizing the seriousness of the consequences that flow from the notice.[89] It has been observed, however, that a notice should not be held inoperative because of minor irregularities, as long as it meets the purpose for which it is required.[90]

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[83] *Mortgages Act*, *supra*, note 13, Form 1.

[84] *Ibid.*, s. 37.

[85] *Ibid.*, s. 38.

[86] Marriott and Dunn, *supra*, note 16, at 298. The authors suggested matters to be raised in the affidavit upon such an application.

[87] *Re Botiuk and Collison* (1979), 26 O.R. (2d) 580, 103 D.L.R. (3d) 322 (C.A.) (subsequent references are to 26 O.R. (2d)).

[88] *Tucker v. Titus* (1913), 5 O.W.N. 651, 25 O.W.R. 574 (H.C. Div.).

[89] *Re Botiuk and Collison*, *supra*, note 87, at 585.

[90] Marriott and Dunn, *supra*, note 16, at 288. The authors refer particularly to s. 27 of the *Interpretation Act*, R.S.O. 1980, c. 219, which provides:

> 27. In every Act, unless the contrary intention appears,
>
> . . . .
>
> (d) where a form is prescribed, deviations therefrom not affecting the substance or calculated to mislead do not vitiate it; ...

The courts have also strictly construed the requirements of service of the notice of an intention to exercise the power of sale. Failure to follow the methods of service specified either under the *Mortgages Act* or by the terms of the mortgage can result in a notice being declared invalid and a sale being set aside. The courts' insistence on technical compliance with the service requirements has occasionally been extreme. In one instance, an express term of a mortgage required that notice be given to the mortgagor, his heirs, executors, or administrators, prior to the exercise of the power of sale. Notice was served on the widow and administratrix, but not upon the heir who was her three year old child. It was held that the contractual requirement of notice was not fulfilled.[91] Similarly, where the lender fails to observe the statutory requirements of service, the subsequent conveyance may be set aside.[92]

A purchaser who buys property from a lender exercising a power of sale would clearly be prejudiced if the conveyance were set aside for a technical breach of the notice requirements. For this reason, section 35 of the *Mortgages Act* creates a saving provision in respect of purchasers for value. Section 35 validates a sale to a purchaser where an incorrect or incomplete notice has been given. However, the benefits of section 35 are not available if the lender has failed completely to give the requisite notice; such failure can still result in the sale being set aside.[93] Nor does section 35 operate to legitimate a sale that is not yet completed.[94] Finally, if negotiations between the borrower and lender have given rise to a renewed requirement to serve a notice of an intention to exercise the power of sale, a purchaser cannot rely on the original notice to validate the sale.[95]

A mortgage may expressly require that a demand or notice must be given by the lender to the borrower, either requiring payment of all or part of the mortgage debt or declaring an intention to exercise the power of sale. If such demand or notice has been given pursuant to a term of the mortgage, section 40 of the *Mortgages Act* prohibits the lender from taking any further "proceeding", without leave of the court, "until after the lapse of the time at or after which, according to such demand or notice, payment of the money is to be made or the power of sale is to be exercised ...". The term "proceeding" has been broadly interpreted to include advertising during the redemption period,[96] accepting partial payment,[97] listing the property with a real estate agent,[98] as well as selling the property by the lender.[99] It has been suggested that even negotiations concerning purchase and sale may constitute a "proceeding" within the terms of section 40.[100]

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[91] *Bartlett v. Jull* (1880), 28 Gr. 140.

[92] *Re Hal Wright Motor Sales Ltd. and Industrial Development Bank* (1976), 8 O.R. (2d) 76, 57 D.L.R. (3d) 172 (Dist. Ct.) (subsequent reference is to 8 O.R. (2d)).

[93] Falconbridge, *supra*, note 2, at 746.

[94] *Re Hal Wright Motor Sales Ltd. and Industrial Development Bank*, *supra*, note 92, at 82.

[95] *Re Botiuk and Collison*, *supra*, note 87, at 589.

[96] *Smith v. Brown* (1890), 20 O.R. 165 (H.C.J.), and *Tucker v. Titus*, *supra*, note 88.

[97] *Re Botiuk and Collison*, *supra*, note 87, at 589.

[98] Marriott and Dunn, *supra*, note 16, at 300.

However, section 40 creates an anomaly, since the language is restricted to a notice or demand made "pursuant to any condition or proviso contained in a mortgage". Accordingly, it applies only to a contractual notice or demand and apparently does not prohibit further proceedings if a notice is given pursuant to the statutory notice requirements under the *Mortgages Act*.

(iii) Lender's Conduct in the Exercise of the Power of Sale

The requirement to give notice of an intention to exercise an extra-judicial power of sale is the chief procedural hurdle that a lender encounters in the exercise of the power. A lender is not subject to any specific statutory prescription regarding the manner in which the sale is to be conducted. However, both equity and the common law have imposed certain obligations on the lender with respect to such conduct. Unfortunately, the standard of care that is required is not entirely clear, and this lack of clarity creates difficulties for both lenders and borrowers.[101]

A lender is in a somewhat ambiguous position in exercising the power of sale. It is clear that, in so doing, a lender is not acting as a trustee of the property. Subject to certain limits, to be discussed below, a lender may exercise the power at any time convenient to him or her and the lender may consider his or her own interests in the conduct of the sale. In the English Court of Appeal case of *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd.*,[102] Salmon L.J. commented on the standard:[103]

> It is well settled that a mortgagee is not a trustee of the power of sale for the mortgagor. Once the power has accrued, the mortgagee is entitled to exercise it for his own purposes whenever he chooses to do so. It matters not that the moment may be unpropitious and that by waiting a higher price could be obtained. He has the right to realise his security by turning it into money when he likes. Nor, in my view, is there anything to prevent a mortgagee from accepting the best bid he can get at an auction, even though the auction is badly attended and the bidding exceptionally low. Providing none of those adverse factors is due to any fault of the

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[99] *Re Mission Construction Ltd. and Seel Investments Ltd.*, [1973] 2 O.R. 190, 33 D.L.R. (3d) 286 (H.C.J.); *Re Hal Wright Motor Sales Ltd. and Industrial Development Bank*, *supra*, note 92; and *Camp-Wee-Gee-Wa for Boys Ltd. v. Clark*, [1972] 1 O.R. 374 (H.C.J.).

[100] Murray, "Judicial Sale and Power of Sale", in Special Lectures of the Law Society of Upper Canada, *Recent Developments in Real Estate Law* (1970) 23, at 48-49.

[101] See discussion *supra*, this ch., secs. 2 and 3(b) and (c)(ii).

[102] [1971] Ch. 949, [1971] 2 All E.R. 633 (C.A.) (subsequent references are to [1971] 2 All E.R.).

[103] *Ibid.*, at 643.

> mortgagee, he can do as he likes. If the mortgagee's interests, as he sees them, conflict with those of the mortgagor, the mortgagee can give preference to his own interests, which of course he could not do were he a trustee of the power of sale for the mortgagor.

As we have indicated, the state of the law with respect to the standard of conduct is unsettled, and the Court in *Cuckmere Brick Co. Ltd.* observed that the authorities were difficult, if not impossible, to reconcile.[104] One line of authority has held that the duty imposed on the lender was merely to act in good faith. Provided that the lender or the lender's agent has not acted fraudulently, wilfully, or recklessly, the lender would not be liable either for his or her conduct or for that of the agent;[105] mere negligence, in other words, would not be actionable. In *Haddington Island Quarry Co. v. Huson*,[106] the Privy Council adopted the principle enunciated by Kay J. in *Warner v. Jacob*:[107]

> The result seems to me to be, that a mortgagee is, strictly speaking, not a trustee of the power of sale. It is a power given him for his own benefit, to enable him the better to realize his mortgage debt. If he exercises it *bona fide* for that purpose, without corruption or collusion with the purchaser, the Court will not interfere, even though the sale be very disadvantageous, unless, indeed, the price is so low as in itself to be evidence of fraud.

However, on occasion, the courts have imposed a more stringent standard of care on the lender and the lender's agents. In *McHugh v. Union Bank of Canada*,[108] a decision of the Privy Council rendered just two years after *Haddington Island Quarry Co.*, it was stated:[109]

> It is well settled law that it is the duty of a mortgagee when realizing the mortgaged property by sale to behave in conducting such realization as a reasonable man would behave in the realization of his own property, so that the mortgagor may receive credit for the fair value of the property sold.

In *Cuckmere Brick Co. Ltd.*, Salmon L.J. emphasized that this principle had been established even before the modern development of the law of negligence. He referred to earlier decisions in which the Privy Council had expressed the clear view that a lender was liable for the difference between the full value of the secured property and the sale price if, from want of due care and diligence, the property had been sold at an undervalue.[110] Salmon L.J. stated:[111]

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[104] *Ibid.*, particularly the judgment of Cairns L.J., at 653.

[105] *Kennedy v. de Trafford*, [1897] A.C. 180, [1895-99] All E.R. Rep. 408 (H.L.); *Farrar v. Farrars Ltd.* (1888), 40 Ch. D. 395; and *J & W Investments Ltd. v. Black* (1963), 41 W.W.R. 577, 38 D.L.R. (2d) 251 (B.C.C.A.) (subsequent reference is to 41 W.W.R.).

[106] [1911] A.C. 722 (P.C.).

[107] (1882), 51 L.J. (Ch.) 642, at 645.

[108] [1913] A.C. 299 (P.C.).

[109] *Ibid.*, at 311.

> It would seem, therefore, that many years before the modern development of the law of negligence, the courts of equity had laid down a doctrine in relation to mortgages which is entirely consonant with the general principles later evolved by the common law.

The duty actually imposed by the English Court of Appeal in *Cuckmere Brick Co. Ltd.* was based on principles of negligence and was extended to the conduct of the lender's agents. Salmon L.J. was of the view that the duty was twofold, that is, to act in good faith and to take reasonable care to obtain the true market value of the property. He stated:[112]

> Approaching the matter first of all on principle, it is to be observed that if the sale yields a surplus over the amount owed under the mortgage, the mortgagee holds this surplus in trust for the mortgagor. If the sale shows a deficiency, the mortgagor has to make it good out of his own pocket. The mortgagor is vitally affected by the result of the sale but its preparation and conduct is left entirely in the hands of the mortgagee. The proximity between them could scarcely be closer. Surely they are 'neighbours'. Given that the power of sale is for the benefit of the mortgagee and that he is entitled to choose the moment to sell which suits him, it would be strange indeed if he were under no legal obligation to take reasonable care to obtain what I call the true market value at the date of the sale.

It is, nevertheless, not altogether clear what constitutes the appropriate price in the sale of the property. Salmon L.J. expressed his difficulty in discerning a difference between a "proper" price and the "best" price, observing that the former term was a little nebulous, and that the latter suggested an exceptionally high price. He preferred a third term, namely, "true market value". But the precise meaning of even this term is not clear. Does it contemplate fair market value as judged in the ordinary course of business, or having regard to the fact that the sale is a forced one?[113]

The weight of authority appears to be that, while a lender is under a duty to take reasonable care to obtain the true market value of the property, a lender need not withhold the property from sale merely because the timing is unpropitious and a better price may be obtained by selling at a later date.[114] However, in a recent decision of the English Court of Appeal, Lord Denning

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[110] *Wolff v. Vanderzee* (1869), 20 L.T. 353 (Ch.), and *National Bank of Australasia v. United Hand-in-Hand and Band of Hope Co.* (1879), 4 App. Cas. 391.

[111] *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd., supra*, note 102, at 644.

[112] *Ibid.*, at 643.

[113] *J & W Investments Ltd. v. Black, supra*, note 105, at 602.

[114] *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd., supra*, note 102, at 643.

M.R. suggested that a lender is not free to disregard entirely the importance of the timing of a sale.[115] He stated:[116]

> There are several dicta to the effect that the mortgagee can choose his own time for the sale, but I do not think this means that he can sell at the worst possible time. It is at least arguable that, in choosing the time, he must exercise a reasonable degree of care.

Cuckmere Brick Co. Ltd. has been followed in *Siskind v. Bank of Nova Scotia*,[117] where Carruthers J. rejected the argument that the lender was required to meet only the lower standard of merely avoiding wilful neglect or default. The lender had sought support for this position from the wording of the extended form of the power of sale contained in the *Short Forms of Mortgages Act*,[118] which provided that the lender should not be responsible for any loss that might arise by reason of a sale unless the loss arose by reason of the lender's "wilful neglect or default". In adopting the test in *Cuckmere Brick Co. Ltd.*, Carruthers J. observed that "the term 'Wilful default or neglect' must be defined in the light of the gloss a variety of reported cases has placed upon those words".[119]

It has been suggested that, in Ontario, the key test concerning whether the standard has been met is whether the lender acted *bona fide* in the attempt to realize the fair market value of the property. It has also been said that the duties of the lender in exercising the power of sale require him or her to take any steps ordinarily taken to ensure that the power of sale comes to the attention of a wide segment of the market for such property. Such steps include advertising, placing a sign on the property, listing the property with a multiple listing service, obtaining appraisals, and ensuring that the listing lasts for whatever is the usual time period for the sale of such properties.[120]

(iv) Staying the Exercise of the Power of Sale

As a general principle, it may be said that the court has jurisdiction to interfere with the exercise of the extra-judicial power of sale at the instance of anyone interested in the proceeds of the sale. However, the court generally has declined to restrain a proper exercise of the power, "except in the most extreme and exceptional cases"[121], unless the applicant for injunctive relief pays into court the principal, interest, and costs owing to the lender.[122]

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[115] *Standard Chartered Bank Ltd. v. Walker*, [1982] 1 W.L.R. 1410, [1982] 3 All E.R. 938 (C.A.) (subsequent reference is to [1982] 3 All E.R.).

[116] *Ibid.*, at 942.

[117] (1984), 46 O.R. (2d) 575 (H.C.J.).

[118] *Supra*, note 68, Schedule B, para. 13, Column Two. The Act has been amended: see *supra*, note 68.

[119] *Supra*, note 117, at 580.

[120] Marriott and Dunn, *supra*, note 16, at 304.

It has been held that an "extreme and exceptional case" will not include a mere claim of hardship.[123] However, the court will intervene where the lender's conduct is harsh or unfair or where the exercise of the power is, in effect, an attempt to avoid the process of the court.[124] In addition, the court will intervene where the borrower can establish fraud on the part of the lender.

Where a borrower moves to enjoin the exercise of a power of sale in cases other than those involving allegations of hardship or fraudulent or inequitable conduct, the general principles governing the availability of injunctive relief apply. In Ontario, these principles have been reviewed most recently by the Court of Appeal in *Yule Inc. v. Atlantic Pizza Delight Franchise (1968) Ltd.*[125]

It may be said that interlocutory injunctions have not been lightly granted by the courts. Certainly, prior to *Yule*, an applicant bore a particularly heavy burden in persuading the court to grant such relief. Generally, an applicant seeking an interlocutory injunction was required to establish a strong *prima facie* case or the application would be dismissed.

In *Yule*, the Court approved and adopted the test established by the English House of Lords in *American Cyanamid Co. v. Ethicon Ltd.*[126] The House of Lords held that it was not incumbent upon the applicant to establish a strong *prima facie* case. Rather, it was sufficient if the applicant satisfied the court that the case was not a frivolous one and that there was a substantial issue to be tried. Once that prerequisite had been satisfied, relief would become dependent upon a consideration of other matters. First, the court would have to consider whether the threatened harm to the applicant would be compensable by damages. If not, the second step was to consider where the preponderance of convenience lay and what the effect of the injunction would be on both parties. Other than in cases of hardship, fraud, or inequitable conduct, an applicant seeking to enjoin the exercise of the power of sale generally will allege either that the lender is about to breach the duty of care in the conduct of the sale, or that the lender has no legal right to exercise the power at all. In the case of an anticipated breach of the lender's duty or standard of care, the lender's right to sell the property is not disputed; rather, the applicant's interest is simply to ensure that a proper price is obtained at the sale. Applying the analysis and principles of *American Cyanamid* and *Yule*, such an applicant would probably be unable to satisfy the court that damages are an insufficient remedy, and, in the absence of fraud or collusion, an injunction generally would not be granted. As a result, the applicant would be left to establish a claim for damages for any breach of the duty of care.[127]

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[121] *Arnold v. Bronstein*, [1971] 1 O.R. 467 (H.C.J.), at 468.

[122] *Standard Realty Co. v. Nicholson* (1911), 24 O.L.R. 46 (H.C.J.), and *MacLeod v. Jones* (1883), 24 Ch.D. 289.

[123] In *Arnold v. Bronstein*, *supra*, note 121, the Court refused to enjoin a sale where the applicant sought relief on the basis that his deteriorating health and the general economic conditions were the reason for his default and that the mortgagee would not be prejudiced by such a postponement.

[124] In *Canada Permanent Trust Co. Ltd. v. Welton Ltd.*, [1973] 2 O.R. 245, 33 D.L.R. (3d) 417 (H.C.J.), a sale was enjoined where, in an action on the mortgagor's personal covenant for payment and possession, and faced with an affidavit of merits by the mortgagor, the mortgagees elected to proceed by way of the exercise of the power of sale. Zuber J. (as he then was) held that the mortgagees, having submitted their rights to the Court, should not now be allowed to step outside the ambit of the action and attempt to enforce their rights in a different way, especially in view of the fact that there appeared to be a triable issue raised.

In *Marshall v. Miles*, [1970] 3 O.R. 394, 13 D.L.R. (3d) 158 (H.C.J.), the mortgagee, having been met with an affidavit of merits showing a triable issue, attempted to resume an earlier exercise of the power of sale. An injunction was granted on the grounds that such conduct was harsh and unconscionable.

[125] (1977), 17 O.R. (2d) 505 (C.A.). See, generally, Potts, "Injunction Applications to Block the Sale Pursuant to a Mortgagee's Power of Sale" (1985), 6 The Adv. Q. 69.

[126] [1975] 2 W.L.R. 316 (H.L.).

Injunctive relief may, however, be granted where the borrower alleges that the lender has no legal right to exercise the power of sale. Where the borrower has a particular attachment to the property subject to sale, the loss of that property would arguably not be adequately compensable by damages. Where the disputed property is, for example, an occupied residence or an active commercial operation, and the borrower satisfies the court that there is a triable issue, it is not unlikely that the court would be persuaded that a remedy in damages would not suffice. Applying the *American Cyanamid* test, the court would then consider whether damages would adequately compensate the lender, should the borrower's allegations prove to be unfounded, and whether the borrower would be financially able to pay such damages. If so, the court would probably enjoin the exercise of the power of sale. On the other hand, in instances of a falling market or a deteriorating property, where a deficiency would likely arise or increase as a result of enjoining the sale, a court may be persuaded that the balance of convenience lies in the lender's favour.

(v) The Lender's Right to Purchase the Property

In general, a lender exercising a power of sale may not purchase the secured property; nor can a lender avoid this rule by selling to a trustee or nominee. Such a sale would be set aside by the court. The rationale for this principle has been stated by Lindley L.J. in *Farrar v. Farrars Ltd.*:[128]

> A sale by a person to himself is not a sale at all, and a power of sale does not authorize the donee of the power to take the property subject to it at a price fixed by himself, even although such price be the full value of the property. Such a transaction is not an exercise of the power, and the interposition of a trustee, although it gets over the difficulty so far as form is concerned, does not affect the substance of the transaction.

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[127] *Re Whatmough and National Trust Co. Ltd.* (1979), 23 O.R. (2d) 452 (H.C.J.).

[128] (1888), 40 Ch. D. 395 (C.A.), at 409.

A sale may also be set aside where it is made to a person who has a close involvement with the lender, such as the lender's agent who acted in respect of the mortgage, the lender's solicitor, or a receiver of the mortgaged property.[129] The mere fact that a lender is a shareholder in a corporation that purchases the property is not sufficient to invalidate the sale. However, such a sale casts a heavy onus upon the lender to establish the propriety of the sale in those instances where the relationship between the company and the lender is a close one.[130]

(vi) Relief from Acceleration

A mortgage almost invariably contains an acceleration clause, which provides that, upon any default by the borrower in the contractual obligation to pay, or upon a breach of any other mortgage covenant, the entire mortgage debt becomes due and payable.[131] In the absence of such an acceleration clause, an action for payment of the debt can be brought only for payments that are actually overdue, and not for the entire mortgage debt.

It is well established that an acceleration clause is not to be characterized as a penalty against which equity will grant relief; rather, it is said to be a valid exercise of the parties' freedom of contract.[132] Prior to statutory intervention, a borrower could obtain relief from the consequences of an acceleration clause only if payment of the arrears, costs, and expenses was made prior to judgment in favour of the lender.[133] Otherwise, the full accelerated amount was payable. The scope of relief from acceleration clauses was broadened by the enactment, in 1953,[134] of what are now sections 21 and 22 of the *Mortgages Act*.

Section 21(1) provides that a borrower may obtain relief from acceleration, as of right, at any time before a sale under the mortgage[135] or before the commencement of an action for the enforcement of the lender's rights under the mortgage. In order to be entitled to relief, the borrower must perform the covenant that is in default or pay the arrears outstanding, and also pay the lender's costs and expenses.

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[129] See, generally, Falconbridge, *supra*, note 2, at 742-44.

[130] *Tse Kwong Ram v. Wong Chit Sen*, [1983] 3 All E.R. 54 (P.C.), and *Farrar v. Farrars Ltd.*, *supra*, note 128. Section 23 of the *Mortgages Act*, *supra*, note 13, provides that the mortgagee may "buy in at an auction". However, it has been suggested that this provision simply allows the mortgagee to buy for the purpose of reselling under the power of sale or having recourse to any other available remedy, rather than to buy for the mortgagee's own benefit: Falconbridge, *supra*, note 2, at 742, *n.* 8.

[131] *Short Forms of Mortgages Act*, *supra*, note 68, Schedule B, para. 15. This Act has been amended: see *supra*, note 68.

[132] *Tylee v. Hinton* (1878), 3 O.A.R. 53, at 60, and *Clemmer v. Planton* (1922), 52 O.L.R. 211 (H.C.Div.).

[133] Falconbridge, *supra*, note 2, at 435-36.

[134] S.O. 1953, c. 66, s. 1(1).

[135] See Falconbridge, *supra*, note 2, at 436, where it is suggested that either a binding agreement of purchase and sale or a completed sale constitutes a sale for purposes of s. 21(1)(a) of the *Mortgages Act*, *supra*, note 13.

Pursuant to section 22(1)(a), if an action has been commenced by the lender, but judgment has not yet been recovered, the borrower may have the action dismissed, as of right, by paying $100 into court as security for costs, and by performing the breached covenant or paying the arrears, together with the lender's costs and expenses. A mere undertaking to perform or pay is not sufficient.

Section 22(1)(b) states that, if judgment has been recovered, but there has been no sale or recovery of possession or final foreclosure, the court has a discretion to stay any further proceedings, upon payment of arrears or performance of the breached covenant by the borrower and, as well, payment of the lender's costs and expenses.[136]

A borrower can default repeatedly and still obtain relief as of right under section 21 or section 22, provided that the default is remedied prior to judgment being obtained by the lender. Where the court has stayed proceedings under section 22(1)(b), and the borrower subsequently defaults again, the lender may apply under section 22(3) to have the stay removed. However, the court has the discretion to refuse such an application and to allow the borrower to remedy the default once more.

4. DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

The remedies of foreclosure and judicial sale are the product of equity's ongoing attempts to balance the interests of borrowers with the legitimate rights and expectations of lenders. However, as we have seen, the policy underlying the remedies has become distorted as the remedies themselves have become mired in cumbersome, time consuming, and costly procedures. As a result, the interests of lenders, subsequent encumbrancers, and borrowers alike have been prejudicially affected, and the elaborate protections inherent in foreclosure and judicial sale, developed by equity and administered by the courts, have become almost entirely avoided by lenders in Ontario through the utilization of the extra-judicial power of sale. The Commission has been advised by representatives of lending institutions that resort to foreclosure and judicial sale proceedings is limited to a very small fraction of cases. It is estimated that, in ninety to ninety-nine percent of the cases, upon a borrower's default, lenders elect to proceed by way of extra-judicial sale rather than hazard the maze of foreclosure and judicial sale.

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[136] "Recovery of possession" has been held to mean possession actually recovered under the authority of a writ issued and enforced pursuant to a judgment for possession: *Czier v. Orr and Orr*, [1954] O.W.N. 676 (H.C.J.). Possession taken other than by means of an order of possession — for example, where the borrower has voluntarily given up possession — will not disentitle the applicant to relief. A token taking of possession by erecting a barricade does not constitute possession within s. 22(1): *MacDonald v. Daker Investment Ltd.*, [1959] O.W.N. 9 (H.C.J.).

This clear flight away from foreclosure and judicial sale need not, however, be lamented. It is arguable that the extra-judicial sale process, if properly conducted, works in the best interests of all parties. The process is more expeditious and less costly than foreclosure, so that the residue available after payment of the mortgage debt is maximized, to the benefit of both subsequent encumbrancers and borrowers. As compared with foreclosure and judicial sale, there is certainty in the extra-judicial sale procedure and a finality to the sale, provided that the notice requirements are observed with regard to interested parties.

However, the extra-judicial power of sale procedure is not without its flaws. Critics of the process voice concerns about the notice requirements and the approximately two month delay period prior to such sales. They say that this time period is insufficient to allow borrowers to put their affairs in order and either refinance the debt or sell the property themselves.

Perhaps the most serious criticism of the extra-judicial sale procedure relates to the conduct of the sale itself. Concern has been expressed that lack of judicial scrutiny can result in sales at an undervalue by the lender. Because uncertainty exists regarding the standard required in the conduct of the sale, lenders may be inclined to make no greater effort than is necessary to satisfy their own debt, without proper regard for the interests of either the borrower or subsequent emcumbrancers. Often, borrowers will be unaware that the lender is under an obligation to exercise a duty of care, however nebulous or ill-defined, in the conduct of the sale; in many cases, borrowers are financially unable to initiate an action for breach of the lender's duty.

The Commission is of the view that the policy underlying the remedies to be made available to a lender should be based on a recognition that the lender's entitlement is merely to payment of the debt. That entitlement must be protected by the development of effective remedies that will ensure that the lender is not placed in a position where recovery of the debt is unduly delayed or jeopardized, and that the highest realizable value for the property is obtained, not just for the benefit of the lender, but for the benefit of all interested parties. By the same token, the Commission recognizes that there is an equally important need to protect borrowers from overreaching by lenders. In the Commission's view, a careful balancing of interests — control of potential abuse by the lender, coupled with an efficient remedial procedure — should be the goal of law reform in this area.

It would seem that, while foreclosure and judicial sale have largely been rejected by lenders, even the favoured remedy, extra-judicial sale, is deficient in several respects. The issue faced by the Commission is, then, whether the desired balance of interests would be best achieved through the rehabilitation of the foreclosure and judicial sale procedure and, perhaps, the abolition of the extra-judicial power of sale, or whether the interests of all parties would be better served by relying exclusively on the extra-judicial sale process, modified where necessary so as to expand the protections of the borrower within that process.

5. THE LAW IN OTHER JURISDICTIONS

(a) FORECLOSURE AND JUDICIAL SALE

(i) Canadian Torrens Jurisdictions

Under the Torrens, or land titles, system utilized in the Western provinces of Canada, a mortgage does not involve a transfer of legal title to the lender. Therefore, while the terminology of foreclosure is retained, the legal process of foreclosure differs from that developed by equity, as discussed above. Under the Torrens system, since a mortgage is merely a charge on the land, it is only upon the granting of an order absolute of foreclosure that legal title is transferred to the lender: by such an order, the registrar of titles is directed to register the lender on title as the absolute owner of the property, and all subsequent interests are declared to be extinguished.[137] While the transfer has the effect of extinguishing all the lender's rights as against the borrower, in extreme cases a borrower can still have an order absolute of foreclosure opened and have title retransferred to him.[138]

In both Manitoba[139] and Alberta,[140] an order of foreclosure will not be granted upon first application by a lender. Rather, in every case, the court will order that a judicial sale should be attempted first. If no offer to purchase, sufficient to satisfy the mortgage debt, has been received within six months of the default, an application for an order absolute of foreclosure may be made. The borrower is then generally given a further one month to redeem the property, after which title will be transferred to the lender and the borrower's interest will be extinguished.[141]

(ii) England

The development and use of the foreclosure and judicial sale procedure in England was the foundation of, and remains similar to, the Ontario practice. Foreclosure and judicial sale proceedings are not now generally used in England, due to the slow, cumbersome, and costly nature of the procedural requirements.[142] Considering the similarities in the English and Ontario development and use of these mortgage remedies, it is not surprising to find that

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[137] DiCastri, *Thom's Canadian Torrens System* (2d ed., 1962), at 500 *et seq.*

[138] *Mackie v. Standard Trusts Co.* (1922), 67 D.L.R. 201 (Alta. S.C., App. Div.); *Richards v. Thompson* (1911), 4 Sask. L.R. 213 (S.C.); *Manufacturers Life Ins. Co. v. Croker*, [1920] 3 W.W.R. 331 (Sask. K.B.); and *Interior Trust Co. v. Osadchuk*, [1925] 1 W.W.R. 957 (Sask. K.B.).

[139] *Real Property Act*, R.S.M. 1970, c. R30, s. 126(1).

[140] *Law of Property Act*, R.S.A. 1980, c. L-8, s. 41(2).

[141] *Real Property Act*, *supra*, note 139, s. 129(3), and *Law of Property Act*, *supra*, note 140, s. 42(2).

[142] For example, in England, as in Ontario, a final order of foreclosure can be reopened on equitable grounds. See, generally, Fisher and Lightwood (ed. Tyler), *Law of Mortgages* (9th ed., 1977) (hereinafter referred to as "Fisher and Lightwood"), at 382 *et seq.*

English foreclosure procedure has become the subject of many of the same criticisms as those made in Ontario.

As a result, the practice of lenders in England, as in Ontario, has been to utilize the contractual, that is, extra-judicial, power of sale almost exclusively, rather than foreclosure and judicial sale. An implied contractual power of sale is provided by statute[143] and is almost invariably relied upon in lieu of an express contractual power in the mortgage agreement.[144]

(iii) United States

a. General

The principles and practice of foreclosure in the United States were initially adopted from English law. However, it appears that borrowers did not become the object of sympathy in the American courts as they did in the Court of Chancery in England.[145] Extensions and delays with respect to the redemption periods were rarely granted to borrowers and the opportunity to redeem after the final order of foreclosure was almost unavailable. As a result, the American law of foreclosure has been described as operating "summarily, harshly and oppressively".[146]

The legislative response to the strict operation of foreclosure in many American states was to replace foreclosure with judicial sale. Today, judicial sale is available in all American jurisdictions, and is either the exclusive, or the most generally utilized, remedy for realization of the secured debt.[147] However, this process too has attracted criticism.

In the majority of American jurisdictions, a lender is entitled to bid on the property and generally does so.[148] In most states, the sale price is regarded as determinative of the market value of the property.[149] The lender is also generally entitled to a judgment for any deficiency in the debt after a sale of the property.

Many jurisdictions provide for a statutory redemption period after sale. This right of redemption is clearly intended for the benefit of the borrower; however, some commentators have observed that, in fact, it may operate to depress the value of the land, since it is unlikely that any person, other than the lender, will bid at full market value if there is a prospect that the sale will be set aside.[150]

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[143] *Law of Property Act, 1925*, c. 20, s. 101(1)(i).

[144] Turner, "The English Mortgage of Land as Security" (1933-34), 20 Va. L. Rev. 729.

[145] Tefft, "The Myth of Strict Foreclosure" (1937), 4 U. of Chi. L. Rev. 575. See, generally, Osborne, *Handbook on the Law of Mortgages* (2d ed., 1970), at 905 *et seq.*

[146] Tefft, *supra*, note 145, at 595.

[147] Osborne, *supra*, note 145, at 661.

[148] *Ibid.* In England, a lender must obtain special leave in order to bid at a judicial sale.

[149] Tefft, *supra*, note 145, at 593.

The potential for abuse is obvious. The lender will often bid for the property at an undervalue and frequently will be successful, since ordinarily the lender is the only bidder. The lender is then free to pursue the borrower for the difference between the price paid for the land and the mortgage debt outstanding. The less the lender pays for the land, the greater the amount that can be recovered as a deficiency.

b. Uniform Land Transactions Act

The remedy of foreclosure is available under the American Uniform Land Transactions Act.[151] However, its scope is very limited. Section 3-505 of the Act provides that, where the debtor is a "protected party" within the meaning of the Act,[152] in the absence of a consent to foreclosure the secured creditor may not take the property in satisfaction of the debt. In such a case, the remedy of the secured creditor is limited either to judicial sale or to the exercise of a contractual power of sale.

Where the debtor is not a "protected party", a secured creditor may take the land in satisfaction of the debt by giving written notice of this intention to the debtor and to any other person who has a registered interest in the property. If no objection is made within five weeks, consent to foreclosure is presumed and the secured creditor has the right to take the property.[153] However, if any interested person makes a timely objection to foreclosure, the secured creditor's remedies are limited either to judicial sale or to the exercise of a contractual power of sale.[154]

(b) CONTRACTUAL POWER OF SALE

(i) The Lender's Standard of Care

a. Alberta

We turn first to consider briefly one portion of a 1984 draft *Real Property Security Act*, commissioned for discussion purposes by the Alberta Institute of Law Research and Reform.

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[150] Turner, "An English View of Mortgage Deficiency Judgments" (1935), 21 Va. L. Rev. 601, at 606.

[151] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

[152] Section 1-203(a) defines "protected party" to include an individual who gives a security interest in "residential real estate", all or part of which he or she occupies, or intends to occupy, as a residence. Section 1-203(b) defines "residential real estate". See *supra*, ch. 4, sec. 4, where § 1-203(a) is reproduced and, generally, ch. 4, where the Commission offers recommendations in respect of "protected borrowers".

[153] Uniform Land Transactions Act, *supra*, note 151, § 3-505(d).

[154] *Ibid.*, § 3-505(b) and (c).

The Act stipulates, among other things, the standard of care required of a secured creditor in the conduct of an extra-judicial sale. Section 3.4(2) of the Act provides that a sale may be by tender, after reasonable efforts have been made to invite tenders, or by private negotiation. The property may be sold by one or more contracts and as a unit or in parcels, as the secured creditor sees fit. The sale may be at any time or place and on any terms, including a sale on credit. The overriding requirement, as set forth in section 3.4(2), is that "every aspect of the sale including the method of sale, advertising, time, place and terms must be as reasonable as a person selling for his own account might utilize".

The Comment to the Act suggests that the standard proposed is less stringent than that imposed on a trustee disposing of real property for the beneficiaries of a trust. While this conclusion may be open to question, it would appear that this standard is higher than the standard that has been imposed by equity and the common law, which, although not completely settled, ranges between a minimum requirement that the lender avoid wilful default and the general negligence standard of reasonable care.[155] By requiring the same conduct for lenders as for persons selling for their own account, the Alberta standard arguably would, for example, require a secured creditor to withhold the property from sale in circumstances of a very depressed real estate market.

b. American Uniform Land Transactions Act

The Uniform Land Transactions Act[156] provides that a lender may sell the property "at a public sale or by private negotiation, by one or more contracts, as a unit or in parcels, at any time and place, and on any terms including sale on credit, but every aspect of the sale, including the method, advertising, time, place and terms, must be reasonable".[157] Section 3-508(a) also provides that the lender may buy at any public sale, and, if the sale is conducted by a fiduciary or other person not related to the lender, at a private sale as well.

The Comment to section 3-508 emphasizes that the Act does not require that the sale be conducted by a disinterested third party, such as a trustee. Nor does the Act prohibit the lender from purchasing the property, which the lender is able to do under existing law in most American jurisidictions. The Comment explains that the requirement that the sale be conducted in a reasonable manner requires that the person conducting the sale use the ordinary methods of making buyers aware of the sale that are used when a person is voluntarily selling his or her own land.

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[155] See discussion *supra*, this ch., sec. 3(c)(iii).

[156] *Supra*, note 151.

[157] *Ibid.*, § 3-508(a).

c. *Other Statutory Standards*

The American Uniform Commerical Code[158] and the Ontario *Personal Property Security Act*[159] both adopt a standard of "commercial reasonableness" in the conduct of a sale of secured personal property. The latter Act provides that the secured creditor may dispose of the property "at any time and place and on any terms so long as every aspect of the disposition is commercially reasonable".[160]

Section 9-509 of the Uniform Commercial Code establishes certain tests that are applicable in determining what constitutes commercial reasonableness. Section 9-507(2) provides that the fact that a better price could have been obtained by a sale at a different time or by a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner that the goods are sold in any recognized market for such goods, or sells at the price current in such a market at the time of the sale, or if he or she has otherwise sold in conformity with the reasonable commercial practices of dealers in the type of property sold, section 9-507 provides that the secured party has acted in a commercially reasonable manner. Furthermore, a disposition that has been approved in any judicial proceeding or by any *bona fide* creditors' committee or by a representative of creditors is conclusively deemed to be commercially reasonable. The Act makes it clear, however, that there is no requirement for such approval, nor does the absence of such approval indicate that the sale is not commercially reasonable.

The Ontario *Personal Property Security Act* does not establish statutory tests or factors relating to commercial reasonableness. Rather, the determination of what constitutes commercial reasonableness under the Act has been left to the courts, having regard to the particular facts of each case.[161] One commentator has cautioned against undue reliance on American case law in the interpretation of commercial reasonableness, since these cases are based in part on the particular statutory tests of section 9-507 of the Uniform Commercial Code.[162]

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[158] National Conference of Commissioners on Uniform State Laws, Uniform Commercial Code, Uniform Laws Annotated, Vol. 3A, § 9-504.

[159] R.S.O. 1980, c. 375, s. 59(3).

[160] *Ibid*. See, also, § 9-504(3) of the Uniform Commercial Code, *supra*, note 158.

[161] See *Re Station de L'Ervleur St-Redempteur; Re Gerard Souligny Inc.; Ralston Purina Canada Inc. v. National Bank of Canada* (1984), 4 P.P.S.A.C. 231 (Master S.C.O.), for a case that considers the standard of "commercial reasonableness". In that case, the secured creditor realized less than one-third of the value of the borrower's secured assets upon a sale.

[162] McLaren, *Secured Transactions in Personal Property in Canada* (1979), Vol. 1, at 8-16, *n*. 26.

(ii) Notice and Delay Periods Prior to the Exercise of the Power of Sale

a. England

There is no statutory notice requirement or delay period prior to the exercise of an express power of sale in England. However, provision is usually made in a mortgage that the power will not be exercised until after notice to the borrower, and it has been said that a power to sell without notice is of an oppressive nature.[163]

In fact, express powers of sale are rarely used in English mortgages. Mortgages generally utilize a power of sale implied under section 101 of the *Law of Property Act, 1925.*[164] Section 103 of the Act provides that the statutory power may be exercised where interest has been in arrears for two months; notice is not then required to be given either to the borrower or to any other person.[165]

b. American Uniform Land Transactions Act

Section 3-508 of the Uniform Land Transactions Act[166] stipulates that a notice indicating the time and place of a public sale, or the borrower's intention to sell his or her property privately, must be given to all persons having an interest in the sale. Except in the case of a ''protected party'',[167] notice may be sent at any time after default, as provided by the mortgage. The Act creates a minimum five week waiting period, after service of the notice of intention to sell, before the secured creditor may sell the property.

A longer delay period is provided where the secured property is a residence occupied by a protected party or a person related to a protected party. In such cases, the notice of intention to sell may not be given until either default of payment has lasted five weeks or, where default is with respect to some other obligation and the borrower has been notified of the default, the borrower has failed to commence, and diligently proceed with, performance of his or her contractual obligation within five weeks. In either case, section 3-508 prohibits a sale of the property until the expiry of a minimum of a further five weeks after notice has been given. Therefore, a protected party, or a person related to such party, is entitled to a minimum ten week delay period in which either to remedy the default or to sell the property privately.

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[163] See, generally, Fisher and Lightwood, *supra*, note 142, at 360, citing *Miller v. Cook* (1870), L.R. 10 Eq. 641.

[164] *Supra*, note 143.

[165] Fisher and Lightwood, *supra*, note 142, at 364.

[166] *Supra*, note 151.

[167] See *supra*, note 152.

Unlike section 40 of the Ontario *Mortgages Act*,[168] which prohibits a further "proceeding" until the lapse of the notice period, except by court order,[169] the Uniform Land Transactions Act prohibits only the sale itself from being held until the expiration of the notice period. There is no prohibition against the lender advertising or taking any other steps in preparation for a sale; presumably, then, a sale by the lender can take place immediately upon the expiration of the delay period.

6. PROPOSALS FOR REFORM

(a) THE PRIMARY REMEDY: A NEW EXTRA-JUDICIAL POWER OF SALE

The Commission has already stated its view that reform of the law relating to land security remedies should be based on the principle that the lender's right is merely to payment of the debt.[170] On the one hand, therefore, the law must ensure that recovery of the debt is not unjustifiably delayed or jeopardized, and that the highest realizable value for the property is obtained. On the other hand, the law must protect borrowers from overreaching by lenders.

As we have seen,[171] the remedies of foreclosure and judicial sale are both cumbersome and costly. Accordingly, lenders almost never use these remedies; rather, they use the extra-judicial power of sale.

The Commission has come to the conclusion that the extra-judicial sale process, if modified, would operate in the best interests of all parties. The process is more expeditious and less costly than foreclosure and judicial sale, so that the money available after payment of the loan is maximized. Moreover, there is certainty to the procedure and finality to the sale.

However, we have also noted that the extra-judicial power of sale procedure is not without its flaws. Critics contend that the notice and delay periods prior to such sales do not allow borrowers sufficient time in which either to refinance the debt or to sell the property privately. Concern has also been expressed that the lack of judicial scrutiny respecting the conduct of the sale can result in sales at an undervalue. Lenders may well pay too little heed to the interests of the borrower, the subsequent encumbrancers, or the borrower's unsecured creditors.

The Commission is of the view that the appropriate balance of interests of the borrower and lender would best be achieved by abolishing the largely unused foreclosure and judicial sale procedures, while maintaining the extra-judicial power of sale and improving the safeguards for borrowers in the context of the latter procedure. As we shall see, these improvements would include an expansion of the delay period after default, and before sale, thereby giving the borrower adequate time either to refinance or to sell the property privately for a price likely to be higher than would be obtained otherwise.[172] They would also involve a clarification of the standard of conduct required of a lender in any sale following the expiration of the delay period.[173]

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[168] *Supra*, note 13.

[169] See *supra*, this ch., sec. 3(c)(ii).

[170] See *supra*, this ch., sec. 4.

[171] See *supra*, this ch., secs. 3(a) and (b).

Accordingly, for the reasons advanced above, the Commission recommends that the primary remedy for realization of a lender's security should be a modified extra-judicial power of sale,[174] the features of which are discussed in the following sections of this chapter. The process of extra-judicial sale should be modified in order to improve the protection afforded to borrowers and all other persons interested in the proceeds of sale. In light of our endorsement of a new extra-judicial power of sale remedy, we further recommend that the remedy of judicial sale should be abolished and that the lender's right to take the property in satisfaction of the debt, that is, to exercise foreclosure, should be limited to those circumstances discussed below.[175] Finally, under recommendations to be made later in this chapter, the borrower's right to obtain relief from acceleration of the secured debt would be maintained.[176]

(b) THE REFORMED EXTRA-JUDICIAL POWER OF SALE

As indicated above, the Commission's recommendation that the extra-judicial power of sale procedure should become the primary remedy for realization of the security is subject to a further proposal that the existing procedure should be modified. We now turn to a description of the proposed new power of sale regime.

(i) Notice of Default

We understand that it is the current practice of many lenders to notify the borrower when default arises,[177] prior to taking any formal steps towards realization of the security. This practice is intended to encourage the borrower to bring the agreement into good standing. However, a lender is generally under no obligation to give any notice advising of default. In the Commission's earlier discussion concerning the desirability of a more formalized requirement on the part of lenders to disclose certain information to borrowers and prospective borrowers,[178] we expressed the view that this common practice should be made a statutory requirement. Accordingly, we recommended that, prior to taking any steps towards realization of the security upon the borrower's default, the lender should be required to serve on the borrower a notice of default.[179]

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[172] See *infra*, this ch., secs. 6(b)(i)-(vii).

[173] See *infra*, this ch., sec. 6(b)(viii).

[174] See the draft *Land Security Act* proposed by the Commission (hereinafter referred to as "draft Act"), *infra*, Appendix 1, s. 6.4.

[175] See discussion *infra*, this ch., sec. 6(c).

[176] See discussion *infra*, this ch., secs. 6(b)(i) and (xvii).

[177] The Commission believes that the borrower and lender should continue to be free to determine what constitutes default under the security agreement.

[178] See *supra*, ch. 7, sec. 2(c)(i)f.

We recommended further that the notice should not be served until the default has continued for a minimum of ten business days.[180] The parties would be at liberty, of course, to agree to a longer period of time. However, the proposed minimum ten day period would not be capable of being abridged or waived.[181]

The notice of default recommended by the Commission would be in a form prescribed by regulation and would set out, in plain language, the details of the borrower's default, the rights and remedies of the lender and the borrower, and such other information as may be prescribed.[182] In order that the borrower is informed of the state of the secured debt, so that he or she may know what is necessary to bring the account into good standing where there has been default in payment, the lender would be required to serve with the notice of default a statement of account.[183] The method of service is described later in this Report.[184]

We recommend here that, at any time before the commencement of sale proceedings, the borrower should be entitled to reinstate the agreement, either by paying the arrears that are due or by performing any covenant that is in default.[185] For the purpose of reinstatement, arrears should include all amounts that are payable to the lender at the time of payment, but not the accelerated amount that may be triggered by the default itself.[186] Arrears should be defined to include, as well, any amounts payable by the lender for the reasonable protection of the lender's security, such as taxes, insurance premiums, condominium maintenance fees, and the costs of commercially reasonable repairs.[187] Provided that such amounts are payable by the lender under the terms of the agreement, it should not be necessary that the lender have actually made such payments before requiring their payment as part of the arrears. In no case, at this preliminary stage, would arrears include any legal fees incurred by the lender.[188]

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[179] Draft Act, s. 6.3(1).

[180] *Ibid.*, s. 6.3(2).

[181] *Ibid.*, s. 2.5.

[182] *Ibid.*, 6.3(3).

[183] *Ibid.*, s. 6.3(4). With respect to the statement of account, see *supra*, ch. 6, sec. 3.

[184] See *infra*, ch. 11, sec. 2.

[185] Draft Act, s. 6.3(7).

[186] *Ibid.*, s. 6.3(8). For discussion of acceleration clauses, see *supra*, this ch., sec. 6(b)(xvii).

[187] Draft Act, s. 6.3(8).

[188] With respect to relief from acceleration following service of the notice of sale, see *infra*, this ch., sec. 6(b)(xvii).

We have concluded and, accordingly, recommend that a borrower should be afforded a minimum of ten business days, from service of the notice of default, within which to remedy the default, after which the lender should be entitled to commence sale proceedings.[189]

(ii) Notice of Sale

If a borrower fails to remedy the default within the proposed ten day minimum period, the lender should be entitled to serve on the borrower a notice of sale, together with a statement of account. The form of this notice should be prescribed by regulation and should specify the date after which the lender intends to take steps to sell the property,[190] as discussed below.

The notice of sale and the statement of account should be served on the following persons,[191] other than persons whose interests in the secured property are prior to the interest of the lender:[192]

1. Where the property is registered under the *Land Titles Act*,[193] every person appearing by the register of title and by the index of executions to have an interest in the property.

2. Where the property is registered under the *Registry Act*,[194] every person appearing by the abstract index and by the index of writs received for execution by the sheriff of the county or district in which the property is situate to have an interest in the property.

3. Where there is a statutory lien against the property in favour of the Crown or any other public authority and the lender has written notice of the lien, the Crown exercising the power of sale or other public authority claiming the lien.

4. Where the lender has actual notice of any other interest in the property and where such notice has been received prior to the giving of the notice of sale, the person having such interest.[195]

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[189] Draft Act, s. 6.5(1).

[190] *Ibid.*, s. 6.5(1), (2), and (4). With respect to the date of sale, see *infra*, this ch., sec. 6(b)(iii).

[191] Draft Act, s. 6.6(1).

[192] Persons with prior interest would not be affected by the sale and any purchaser would take subject to the prior interests.

[193] R.S.O. 1980, c. 230.

[194] R.S.O. 1980, c. 445.

[195] Paragraphs 1-4 reproduce, with minor variations, s. 30(1)1-4 of the *Mortgages Act*, *supra*, note 13.

5. Where the property is a matrimonial home within the meaning of Part II of the *Family Law Act, 1986*,[196] the spouse[197] of the borrower unless

    (a) the spouse has released all rights under Part II of the Act by a separation agreement,

    (b) a court order has been made releasing the property as a matrimonial home, or

    (c) the property ceases to be designated as a matrimonial home pursuant to the provisions of the Act.

6. The guarantor of the borrower.[198]

The method of service is considered in chapter 11 of this Report.

(iii) The Delay Period Before Sale

We believe that a lender should not be entitled to take immediate steps to sell the property after service of the notice of sale. Rather, the Commission recommends that there should be a period of delay prior to the exercise of the proposed extra-judicial power of sale.[199]

In our view, a delay period prior to sale should be designed to serve two primary functions. First, the delay period should provide a borrower with time to do one of two things. It should allow the borrower to arrange his or her affairs and put the security agreement in good standing by remedying the default, so that the existing contractual relationship with the lender can continue in accordance with the terms of the agreement; or it should permit the borrower to refinance the debt. Secondly, the delay period should give a borrower who is unable to reinstate the agreement or refinance the debt an opportunity to sell the property prior to the lender taking control of the sale proceedings.

The appropriate length of the delay period prior to sale must, therefore, balance the borrower's concern that sufficient time be allowed to reinstate the agreement, redeem the property, or sell it privately, with the lender's concern about possible losses due to unwarranted delay. The delay should not be longer than is necessary for the borrower to obtain a real benefit.

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[196] *Supra*, note 17.

[197] As defined *ibid*., s. 1.

[198] See *394363 Ontario Ltd. v. Fuda* (1986), 54 O.R. (2d) 443 (C.A.), leave to appeal denied, (1987), 56 O.R. (2d) 608 (S.C.C.), in which it was held that a guarantor was not entitled to receive a notice of sale.

[199] Draft Act, s. 6.7(1).

The standard six month redemption period in foreclosure proceedings under the former Rules of Practice[200] had been criticized as being unduly long and, therefore, prejudicial to lenders. Under the new Rules of Civil Procedure,[201] the standard redemption period in a foreclosure proceeding has been reduced to sixty days.[202]

In the Commission's view, the desired balance of interests between borrowers and lenders would be achieved, in part, by our recommendation that a lender should not be entitled to serve a notice of sale until default has continued for a minimum of twenty business days and a notice of default has been served. In addition, we recommend that the borrower should have a total of four months after default, and not less than two months after service of the notice of sale, in order to reinstate the security agreement, refinance the debt, or sell the property.[203]

During the proposed delay period, the lender should be expressly prohibited from taking any steps relating to the exercise of the power of sale. This would prohibit the lender from advertising or listing the property for sale and, clearly, from negotiating a sale or selling the property during this period.[204] However, the Commission's recommendation is not intended to affect the lender's right to possession of the secured property during this period.[205]

(iv) Different Delay Periods for Protected Borrowers and Others?

The Commission has considered a suggestion that the proposed delay period should be longer in the case of protected borrowers,[206] as provided for under the American Uniform Land Transactions Act.[207] We are of the view that, with respect to delay periods, a distinction between residential and non-residential, or between consumer and commercial, loans is neither useful nor desirable, in light of the policy underlying the imposition of such periods. Upon default, all borrowers have identical interests that are served by the delay periods: they all wish to obtain sufficient time to either reinstate the agreement, refinance the debt, or sell the property themselves. The likelihood of improvement in a borrower's financial prospects in circumstances of default is not dependent on the nature of the borrower or the property; nor does it turn on the purposes for which the debt has been incurred. There is no logical connection between these factors and the length of the delay period. Accordingly, we recommend that the delay period should be uniform for all borrowers and lenders.

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[200] *Supra*, note 25.

[201] *Supra*, note 14.

[202] See discussion *supra*, this ch., sec. 3(a)(iii).

[203] Draft Act, s. 6.5(3).

[204] *Ibid.*, s. 6.7(1).

[205] The lender's rights to possession are discussed *infra*, ch. 10.

[206] See *supra*, ch. 4.

[207] *Supra*, note 151. See *supra*, this ch., sec. 5(b)(ii)b.

(v) Abridgement or Exclusion of the Delay Period

a. Abridgement or Exclusion by Agreement Between the Parties

It should be clear from the foregoing that we regard the protection afforded by the proposed delay period to be of substantial importance to all borrowers. However, it has been suggested that the parties should be free at the outset to abridge or exclude the delay period on the basis of freedom of contract. The Commission does not agree. We believe that, at the commencement of the relationship between the borrower and the lender, it would not be justifiable to permit the borrower to abridge or waive the rights that we have just recommended. At this stage, prior to any default and the subsequent unfolding of events, the borrower may not pay sufficient attention to the implications of this course of action.

It has also been suggested that the parties should be free to abridge or waive the delay period after service of the notice of default since, upon default, a borrower will have a better grasp of his or her financial status and ability to reinstate the agreement, refinance, or sell the property. Arguably, at this later juncture, the borrower may see it in his or her interest to forego the proposed rights: the borrower may wish to consent to an immediate sale of the secured property and may further wish to allow the lender to conduct such a sale. However, while we would agree in general that a borrower should be entitled to take control of his or her own affairs, we do not believe that the borrower should be permitted to consent to such a sale immediately upon service of the notice of default.

At the time the notice of default is served on the borrower, he or she may, in fact, have no clear idea whether it is possible to remedy the default. Professional advice may have to be sought. We do not wish to see the borrower confronted with an abridgement or waiver agreement at this juncture, when the borrower may well be highly vulnerable and easily convinced to give in.

Accordingly, we recommend that the delay period prior to the exercise of the extra-judicial power of sale should not be subject to abridgement or exclusion by agreement between the parties at any time prior to service of the notice of sale, but that the parties should be free to agree in writing to abridge or exclude the delay period after that time.[208]

b. Abridgement by the Court

Under existing foreclosure proceedings, lenders have the right to apply to the court for an order abridging the time for redemption in circumstances of potential loss to the lender, such as where there is a falling real estate market or rising interest rates.[209] We believe that jurisdiction of this kind would import a reasonable degree of flexibility into the recommended extra-judicial power of sale procedure. For example, the court may be satisfied that the normal delay in the sale would be detrimental to the parties having an interest in the secured property. Accordingly, while we have recommended that the proposed delay period should not be subject to exclusion or abridgement by agreement between the parties prior to service of the notice of sale, we recommend here that a lender exercising a power of sale should be entitled to apply to the court at any time, without notice to the borrower, for leave to sell the secured property.[210]

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[208] Draft Act, s. 6.11(2).

We recognize that there may be circumstances where the risk of loss from delay lies not with the lender who has taken steps in the exercise of the power of sale, but rather with a subsequent lender. For example, where property is heavily encumbered, a borrower will often decide that there is no point in making any effort to sell the property during the delay period. A lender whose debt is well secured may not be inclined to apply to the court for leave to sell the property, as proposed above. In such a situation, it might be in the interest of the subsequent lender to have the property sold quickly at the best possible price, in order to recover a larger surplus after the lender's debt is paid. Accordingly, we recommend that a subsequent lender should also be entitled to apply to the court at any time for leave to have the property sold immediately.[211]

In some cases, the court may wish to abridge the delay period only where notice has been given to certain persons. Accordingly, we recommend that, having regard to all the circumstances, the court should be empowered to grant leave to exercise the power of sale without notice, or with notice to such persons, in such manner, and within such time as the court considers proper.[212] The court order should be conclusive of the matters determined in the order.[213]

(vi) Extending the Delay Period

We now turn to consider whether there should be a general discretionary power in the courts to extend any delay period.

Certainty in respect of the delay period would benefit both borrowers and lenders. A borrower would know that action must be taken within a specified time in order to reinstate the agreement, refinance, or sell the property. As it stands now with foreclosure, borrowers often delay, sometimes in the vague, but unrealistic, hope that the court will extend the period of redemption on the basis of hardship. A fixed and certain time period would also allow lenders to order their affairs as of a specific date, without having to speculate whether extensions or delays will ensue in a particular case.

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[209] See discussion *supra*, this ch., sec. 3(a)(iv).

[210] Draft Act, s. 6.10(1).

[211] *Ibid.*

[212] *Ibid.*, s. 6.10(2).

[213] *Ibid.*, s. 6.10(3).

The Commission recognizes that the claim of hardship in particular instances of default can be persuasive. However, financial distress of some kind is almost invariably the source of any default and, therefore, if a delay period could be extended simply on this basis, any proceeding could be subject to further delay and uncertainty.

The Commission regards the proposed delay period as reasonable and sufficient. It would allow the borrower enough time to act in the protection of his or her own interests. It should also be emphasized that, under our proposals, the present law respecting a borrower's capacity to act beyond the expiry of the delay period would not be abolished. A borrower would retain the right to present to the lender any buyers for the property[214] at any time prior to a sale by the lender. Accordingly, we recommend that the delay period proposed earlier should be fixed and that there should be no discretionary power in the court to extend it, except with the consent of the parties.[215]

(vii) Staying or Restraining the Exercise of the Power of Sale

Unlike the case of foreclosure, the courts have not generally interfered with the exercise of the power of sale on the ground of hardship. The Commission does not propose any change to this general principle. In cases where the lender is acting improperly or where the lender's right to exercise the power of sale is in dispute, the existing common law relating to the availability of injunctive relief provides the borrower with an effective avenue to enjoin a sale.[216] In those instances where the borrower does not dispute the lender's right to exercise the power of sale, but takes issue with the lender's conduct of the sale, the borrower's remedy will probably be limited to damages, rather than injunctive relief. Accordingly, we recommend that, despite any rule of law or equity, the court should not be entitled to restrain temporarily or permanently the lender's proper exercise of the power of sale, except with the consent of the parties.[217]

(viii) Standard of Care in the Conduct of a Sale

The issue of perhaps paramount importance to the borrower, the subsequent encumbrancers, and the borrower's unsecured creditors, and the matter of greatest uncertainty to lenders, is the standard of care required of lenders in the conduct of an extra-judicial sale. In England, the standard imposed by the common law developed from general negligence principles. While Canadian courts, like their English counterparts, appear to be moving in the direction of a higher standard of care, these developments have not yet crystallized, but are still in a state of flux. Accordingly, we are of the view that a clarification of the requisite standard is of importance to all persons having an interest in the property.

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[214] The borrower could not sell the property at this stage. With respect to the right of a lender, exercising a power of sale, to convey the property to a purchaser, see *Mortgages Act*, *supra*, note 13, ss. 28-29.

[215] Draft Act, s. 7.4(2).

[216] See *supra*, this ch., sec. 3(c)(iv).

[217] Draft Act, s. 7.4(1).

We have already discussed the various standards that have been adopted in Ontario and other jurisdictions.[218] The minimum standard, which would merely require a lender to avoid wilful default, is, we believe, unacceptable, since it fails to reflect the legitimate interests of any other person in the property. On the other hand, we believe that the lender should not be required to meet the very strict standard imposed on a trustee in the sale of trust property. The common law has invariably acknowledged that a lender is not, and ought not to be, in the position of a trustee. We consider this principle to have a sound and practical basis. The lender has been forced into the position of having to sell the property, not through his or her own actions, but because of the borrower's default. The right that the lender exercises is a natural consequence of that default and, moreover, is a right almost invariably bargained for by the parties and contained in the security agreement.

In the Commission's view, therefore, a lender should continue to be entitled to act in his or her own self-interest. However, acting in this manner must not be a mandate for acting entirely without regard to the interests of others. We are of the opinion that a standard that requires the lender to exercise commercially reasonable care balances the potentially conflicting interests involved in a sale of the property.

Accordingly, the Commission recommends that the standard of care required of a lender in the conduct of a sale should be that of commercially reasonable care, and that this standard should be imposed by statute.[219] The proposed standard would require a lender to obtain the highest realizable price possible under existing market conditions, taking account of the fact that the property is being disposed of at a forced sale.

As we have discussed, the American Uniform Land Transactions Act[220] establishes not only a general standard that requires that all aspects of the sale must be reasonable, but also specifies certain relevant aspects of a sale to be considered in determining whether the standard has been satisfied. Such aspects include the method, time, place, terms, and advertising of the sale. The American Uniform Commercial Code[221] not only adopts the standard of commercial reasonableness in the sale of secured personal property, but also establishes tests that are to be applied in determining whether the conduct in question has conformed to that standard.

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[218] See *supra*, this ch., secs. 3(c)(iii) and 5(b)(i).

[219] Draft Act, s. 6.11(3).

[220] *Supra*, note 151. See *supra*, this ch., sec. 5(b)(i)b.

[221] *Supra*, note 158. See *supra*, this ch., sec. 5(b)(i)c.

The Commission has considered whether the factors or tests provided for in the American legislation noted above, or any variant of these factors or tests, should be expressly included as part of the statutory formulation of the standard of commercial reasonableness proposed by the Commission.

We have also considered the suggestion that the test whether the lender has acted in accordance with the statutory standard should be whether a fair price was obtained for the secured property, and not, for example, whether the lender has taken certain prescribed steps in the method or conduct of sale. Since properties differ, it is arguable that detailed statutory guidelines concerning what is reasonable may well be too rigid. They cannot be exhaustive; nor can they be determinative of what is reasonable in all circumstances. Accordingly, some have said that the standard of commercial reasonableness would be better measured by reference to the sale price, having regard to the nature or type of the property being sold, rather than by reference to specific aspects of a sale, which may or may not be relevant in a particular instance.

On balance, the Commission has come to the conclusion that the proposed general standard of commercial reasonableness should be informed by certain specific factors enumerated by statute. We believe that a properly drafted provision enumerating factors for the court to consider in determining whether the lender has met the requisite standard of care in the circumstances of the particular case would provide the necessary guidance to the court without sacrificing flexibility. Accordingly, the Commission recommends that the lender should be entitled to sell the secured property by tender, public sale, private sale, by one or more contracts, as a unit or in parcels, at any time of day and place and on any terms, including sale on credit, but every aspect of the sale, including advertising, time of day, place, and terms should be commercially reasonable, having regard to the nature of the secured property and the circumstances of the sale.[222]

(ix) Timing of the Sale

The Commission has recommended that there should be no extensions of the delay period on any basis, including hardship.[223] For similar reasons, the Commission further recommends that, in determining whether a sale is reasonable, the exact timing of the sale should not be considered a factor.[224] Provided that the lender's conduct is otherwise commercially reasonable, the lender should be free to sell the secured property immediately upon the expiration of the delay period. The lender should not be compelled to speculate concerning possible fluctuations in the real estate market; nor should a court second-guess the lender's decision to sell at a particular time.[225]

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[222] Draft Act, s. 6.11(3).

[223] See discussion *supra*, this ch., sec. 6(b)(vii).

[224] Draft Act, s. 6.11(6).

[225] A lender would arguably be required to engage in such speculation if the proposed Alberta standard were adopted: see discussion *supra*, this ch., sec. 5(b)(i)a.

In the Commission's view, the interests of borrowers and lenders would remain equitably balanced. The protection afforded to a lender needs no further explanation. As we have seen, the protection afforded to a borrower would be twofold. First, the borrower would have the exclusive right to sell the property for four months after default; secondly, the borrower could continue his or her efforts to obtain purchasers for the property at any time until a sale or until the lender has made an application for foreclosure, to be discussed below.[226]

(x) Persons to Whom the Duty of Care is Owed

The conduct of the sale of the property vitally affects all those who have an interest in the property subordinate to that of the lender. As we shall discuss below,[227] the sale of the property would extinguish the interest of both the borrower and all subsequent encumbrancers, leaving the latter as unsecured creditors (at least *vis-à-vis* the property sold) where their debts have not been paid in full from the proceeds of sale. An improperly conducted sale may reduce the amount available to satisfy subsequent encumbrancers and unsecured creditors, as well as the borrower.

The existence of a duty of care in the conduct of sale, and the Commission's proposed commercially reasonable standard of care in respect of that duty, are essentially founded on general negligence principles that have developed from the "neighbour" principle in *Donoghue v. Stevenson*[228] and the "close proximity" test in *Anns v. London Borough of Merton*.[229] In light of this nexus, we recommend that the lender's duty of care should be owed to all persons who, in the reasonable contemplation of the lender, are likely to be injured by a breach of that duty.[230] This recommendation is intended to be broad enough not only to allow subsequent encumbrancers, guarantors, and sureties to recover damages where a lender has not conducted the sale in a commercially reasonable manner, but also, in some cases, to permit recovery by unsecured creditors who might otherwise have claimed a share, or a larger share, of any surplus from a properly conducted sale.

(xi) Limitation of Actions for Breach of the Duty of Care

We believe that, as with any cause of action, it is reasonable that a limitation period should be created that would require persons alleging a breach of the lender's duty of care to act quickly in seeking a remedy. Accordingly, we recommend the establishment of such a limitation period.[231]

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[226] It should be emphasized that, under a recommendation to be made by the Commission in a later section, a lender would not be entitled to take the property in satisfaction of the debt unless the court was satisfied that reasonable efforts had been made to sell the property: see *infra*, this ch., sec. 6(c)(iii).

[227] See *infra*, this ch., sec. 6(b)(xvi).

[228] [1932] A.C. 562 (H.L.).

[229] [1978] A.C. 728 (H.L.).

[230] Draft Act, s. 6.11(7).

[231] *Ibid.*, s. 6.11(8).

In considering what should be the appropriate limitation period, the Commission is cognizant of the current attempts in Ontario to standardize limitation periods into lengths of two, six, and ten year periods.[232] In light of this policy, the Commission recommends that the limitation period for an action alleging a breach of the lender's duty of care in a sale should be two years from the date on which the interest of the borrower in the secured property is terminated.[233] However, the limitation period should not affect the right of any person to raise, at any time, the lender's breach of the duty of care as a defence to an action on the covenant by the lender where there is a deficiency.[234]

(xii) Onus of Proof in an Action for Breach of the Duty of Care

It had been suggested that, in an action alleging a breach of the lender's duty of care, the onus of proof should be on the lender to show that his or her conduct met the proposed standard of commercial reasonableness, since the details of the lender's conduct are clearly within the lender's knowledge. However, the Commission has not been persuaded that there is any reason to shift the usual civil burden from the plaintiff to the defendant in such an action. We recommend, therefore, that there should be no change to the existing rule that the onus of establishing a breach of the duty of care rests on the party alleging it.

(xiii) Waiver or Limitation of the Proposed Standard of Care

With many of the proposed protections for borrowers, such as the delay period before sale of the property, we have prohibited a protected borrower[235] from limiting or waiving the benefit of the protections, while leaving other borrowers free to contract out as they see fit. However, we are of the view that, for two reasons, the proposed standard of commercially reasonable care should not be capable of limitation or waiver by any borrower, and we so recommend.[236] First, we believe that, on principle and as a practical matter, there can be no justification for any lender attempting to avoid the standard of commercial reasonableness; the law ought to encourage, as much as possible, the development of reasonable commercial practices. Secondly, the proposed standard is intended to protect not only borrowers but all persons having an interest in the sale proceeds. It would be inequitable and unreasonable to allow a borrower's consent to a reduced standard of care to affect the rights of other interested persons.

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[232] See Ontario, Ministry of the Attorney General, *Discussion Paper on Proposed Limitations Act* (September, 1977), and the proposed *Limitations Act, 1983*, Bill 160 (3d Sess., 32d Legis., 1983). The Bill did not receive Second Reading.

[233] Draft Act, s. 6.11(9). With respect to the termination of the borrower's interest, see *ibid.*, s. 6.12.

[234] See *infra*, ch. 9.

[235] See *supra*, ch. 4.

[236] Draft Act, s. 2.5.

We are nevertheless aware that, in commercial security arrangements, there are many variables and complexities that may determine what constitutes reasonable care in the circumstances. The parties to such arrangements are usually advised by legal counsel and, more often than not, are quite sophisticated. Accordingly, to permit some flexibility where the borrower is not a protected borrower, the Commission recommends that the parties to a commercial security agreement should be free to define in advance the type of conduct that would satisfy the requisite standard of care in the conduct of a sale.[237]

Such an agreement between the borrower and lender should not, however, be determinative. For example, third parties who have an interest in the sale of the property may take issue with the substance of the agreement. Consequently, we recommend that the agreement between the borrower and lender should not preclude a court from determining the issue whether the lender has, in fact, met the standard of commercial reasonableness.[238] While the agreement between the parties ordinarily would constitute persuasive evidence of commercial reasonableness, the court should be free to make an objective evaluation of the lender's conduct and to award damages to interested parties where it finds that the conduct, while conforming to the agreed terms, has not been commercially reasonable.

(xiv) The Lender's Use of an Agent in the Conduct of the Sale

Where a sale is conducted by the lender's agent, it should be carried out in a commercially reasonable manner. The agent's duty of care should be owed to all persons who, in the reasonable contemplation of the agent, are likely to be injured by a breach of that duty. With respect to liability, it should be noted that, under ordinary principles of agency law, a lender is liable for the actions of his or her agent. We are of the view that the common law regarding a principal's liability for the actions of the agent is sound and, accordingly, should not be changed. The lender and agent should be jointly and severally liable for any loss or damage caused by the agent's failure to meet the standard of commercially reasonable care.[239]

A question arises concerning whether the costs of using an agent should be recoverable. In some cases, it would not be reasonable to expect a lender to arrange and conduct a sale himself. Accordingly, we recommend that, where the use of an agent is commercially reasonable, the costs associated with such use should be recoverable by the lender.[240] However, where an agent is not used, a lender should not be entitled to remuneration for his or her own care and trouble in the sale of the property. We regard the costs of using an agent as, in a sense, extraordinary, occasioned by the inability of the lender to act personally, as would be expected in the usual case.

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[237] *Ibid.*, s. 6.11(9).

[238] *Ibid.*

[239] *Ibid.*, s. 6.11(7).

[240] *Ibid.*, ss. 6.11(5) and 6.13(1)(a).

(xv) Application to the Court for Directions

The Commission has considered whether a lender who is unsure whether certain steps to be taken in the course of a sale would meet the proposed standard of commercial reasonableness should be entitled to seek directions from the court. In this connection, it may be observed that, in exercising the power of sale, a lender is under a similar, but less onerous, duty to that owed by a trustee selling trust property. Trustees have a right under section 60 of the *Trustee Act*[241] to apply to the court for its opinion, advice, or direction on any question respecting the management or administration of the trust property. However, while a trustee may secure a decision concerning the legal nature and extent of his or her duties and powers under the trust instrument, it has been held that section 60 does not entitle a trustee to obtain directions concerning the exercise of the trustee's discretion.[242] In *Re Collins*,[243] Hodgins J.A. observed that, in cases of doubt or difficulty, a trustee can secure sound advice from his or her own solicitor and should, generally speaking, seek out and act on such advice instead of expecting the court to instruct him or her. In short, the court will not decide a question of expediency and prudent business judgment for the trustee.[244]

In the Commission's view, the same approach should apply to a lender in fulfilling the duty of care in the exercise of the power of sale. Accordingly, we recommend that a lender should not be entitled to seek directions from the court concerning whether any steps proposed by the lender meet the standard of commercial reasonableness.

(xvi) Effect of the Sale

The Commission is of the opinion and, therefore, recommends that, upon sale of the property to a purchaser in good faith and for value, the interest of the lender, borrower, and all persons with a subordinate interest in the secured property should be extinguished.[245] For the purpose of the extinguishment of such interests, a sale should be considered to have taken place where the lender has accepted a written offer to purchase the property.[246]

Occasionally, the sale of the secured property will not be completed. In such an event, we recommend that all interests that were extinguished upon the acceptance of the written offer should be revived, and that the interests should rank in terms of their priorities as at the time of the sale.[247] We further recommend that the borrower's entitlement to relief from acceleration, discussed in the section that follows, should also be revived.[248]

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[241] R.S.O. 1980, c. 512.

[242] *Re Collins* (1927), 61 O.L.R. 225, [1927] 4 D.L.R. 770 (App. Div.). See, generally, Waters, *Law of Trusts* (2d ed., 1984), at 897 *et seq*. With respect to s. 60 of the *Trustee Act*, see s. 68 of the proposed *Trustee Act* appended to the Ontario Law Reform Commission's *Report on the Law of Trusts* (1984).

[243] *Supra*, note 242.

[244] *Re Brown* (1929), 35 O.W.N. 335 (H.C. Div.), at 337.

[245] Draft Act, s. 6.12(1).

[246] *Ibid.*, s. 6.12(2).

We further recommend that, where the sale is not completed, the lender should immediately advise the borrower and serve a written notice on any person who was entitled to receive the original notice of sale[249] that his or her interest has been revived.[250] If the service of the notice of sale has been waived by the court with respect to any person, that person should not be entitled to be served with the subsequent notice that his or her interest in the property has been revived.

(xvii) Relief from Acceleration of the Debt

In an earlier section of this chapter, we dealt with the right of a borrower to reinstate the security agreement prior to service of the notice of sale.[251] The Commission believes and, accordingly, recommends that a borrower should also be entitled to relief from the consequences of his or her default at any time between the date of service of the notice of sale and the date on which the borrower's interest is extinguished by the sale or by foreclosure,[252] provided that the borrower pays the arrears due, performs any other covenant breached, pays the amount of any payment made by the lender where the lender has performed a covenant on behalf of the borrower by making a payment to a third party, and reimburses the lender for the costs and expenses that have been reasonably incurred by the lender in exercising his or her rights.[253] We are of the view that this right is sufficiently critical that it should not be capable of abridgement or waiver by agreement between the parties.[254]

As we have discussed, the right to relief from acceleration has been available even to borrowers who have defaulted on a recurring basis. The Commission has been advised that the right to relief has occasionally been abused by commercial borrowers. When interest rates have risen, or when there are cash flow difficulties, some borrowers decide that it is more advantageous to default in payment so that their money is free to be used for other purposes. The financial gain in using the money in this way outweighs the amount, represented by the lender's costs and expenses of taking proceedings, that would have to be paid to reinstate the mortgage at a later date.

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[247] *Ibid.*, s. 6.12(4).

[248] *Ibid.*, s. 6.9.

[249] See *supra*, this ch., sec. 6(b)(ii).

[250] Draft Act, s. 6.12(5).

[251] See *supra*, this ch., sec. 6(b)(i).

[252] Foreclosure is dealt with in the following sections of this chapter.

[253] Draft Act, s. 6.9(1).

[254] *Ibid.*, s. 2.5.

In order to reduce the incidence of such abuse, we recommend that the right to relief from acceleration following service of a notice of sale should be available only once in every twelve month period, except where the lender otherwise agrees. We recommend, however, that this limitation on the availability of relief should not apply with respect to protected borrowers; rather, they should be entitled to relief from acceleration at any time.[255] The Commission is of the view that there is a sound social value in giving protected borrowers every opportunity to remedy a default and save their residence. Provided that the lender is fully compensated, there appears to be no good reason to limit the right of a protected borrower to obtain relief from acceleration at any time. It can be expected that the requirement that the lender must be reimbursed for his or her reasonable costs and expenses will constitute a sufficient deterrent to any abuse of the proposed relief by a protected borrower.

(c) FORECLOSURE

(i) Introduction

Earlier in this Report, the Commission recommended that the extra-judicial power of sale should become the primary method of realization of the secured debt.[256] There will be occasions, however, when an attempted sale of the property is unsuccessful or when the appraised value of the property clearly indicates that a sale of the property would not satisfy the lender's debt. In such cases, a lender may prefer to take the property in satisfaction of the debt rather than to sell it and then pursue the borrower for the deficiency.[257] Accordingly, the Commission recommends that the remedy of foreclosure should be retained, but modified by the recommendations that follow.

(ii) Foreclosure by Consent

Occasionally, it will be apparent that the anticipated proceeds of a sale of the property will not be sufficient to satisfy the amount owing to the lender, including principal and interest and the costs and expenses to which the lender is entitled.[258] The costs of a sale in such a case will simply increase the potential loss to the lender. To deal with such a situation, we recommend that where, after a notice of sale has been served on a borrower, and during the delay period prior to the exercise of the proposed extra-judicial power of sale, it appears that the proceeds of a sale of the secured property would not exceed the lender's debt, the lender should be entitled to send a notice requesting consent to foreclosure.[259] The latter notice should be in prescribed form and should be served on the borrower and subsequent encumbrancers.[260]

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[255] *Ibid.*, s. 6.9(2).

[256] See *supra*, this ch., sec. 6(a).

[257] With respect to such actions against the borrower, see *infra*, ch. 9.

[258] The lender would be entitled to any costs and expenses incurred in the attempted sale and those incurred where the lender has taken possession of the property. The latter remedy is dealt with *infra*, ch. 10.

The lender should include with the notice copies of all appraisals of the property that are in the lender's control or possession.[261] Furthermore, in order that the consequences of consenting or refusing to consent to foreclosure are fully understood by a protected borrower, we recommend that the lender should provide the borrower with a statement, in plain language, specifically describing such consequences.[262] For example, in accordance with recommendations made later in this chapter,[263] the statement would inform the borrower that, after foreclosure, the lender will no longer be accountable to the borrower upon any subsequent sale of the property by the lender and that the borrower will have no right to reopen the foreclosure and seek reconveyance of the property. The statement would also advise the borrower that liability to the lender on the covenant for payment will be extinguished by foreclosure, but that foreclosure does not relieve the borrower of any indebtedness to subsequent encumbrancers. The latter will, of course, remain creditors of the borrower even though their interest in the property is extinguished.

Upon service of the notice requesting consent to foreclosure, the borrower or a subsequent encumbrancer should be entitled either to consent to foreclosure or to refuse such consent.[264] Consent to foreclosure should be given in a prescribed form, which should accompany the lender's notice requesting consent.[265] Consent given by a borrower or subsequent encumbrancer should not be capable of being withdrawn.[266]

The Commission recommends that a borrower or a subsequent encumbrancer should be entitled to refuse to consent to foreclosure by serving a written objection on the lender.[267] During the four month delay period, the borrower or subsequent encumbrancer should be entitled to refuse consent on any ground; after the delay period, it should be possible to refuse consent only where there are reasonable grounds to believe that the proceeds of a sale of the property will exceed the amount owing to the lender who seeks consent.[268] This raises the question whether, where consent is unreasonably withheld, the lender should be required to proceed with what amounts to an unnecessary sale, in which the normal costs and expenses may not be recovered by the lender. We have considered a suggestion that the unreasonable withholding of consent should be discouraged by providing that, where the person with the highest priority of claim to any surplus of the proceeds has unreasonably refused to consent to foreclosure, that person should be liable to pay the lesser of $1,000 or the costs of the sale or attempted sale if the proceeds turn out to be insufficient to satisfy the amount owing to the lender.

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[259] Draft Act, s. 6.15(1).

[260] *Ibid.*, s. 6.15(2).

[261] *Ibid.*, s. 6.15(3)(a).

[262] *Ibid.*, s. 6.15(3)(b).

[263] See *infra*, this ch., sec. 6(c)(iv).

[264] Draft Act, s. 6.15(4).

[265] *Ibid.*, s. 6.15(3)(c) and (4)(a).

[266] *Ibid.*, s. 6.15(5).

[267] *Ibid.*, s. 6.15(4)(b).

[268] *Ibid.*

The problem with this proposal is the difficulty in determining when a refusal is unreasonable. Borrowers point out that, frequently, the only real test of the market value of a property is actually placing it on the market; appraisals, they argue, are often misleading. They suggest that the proposed imposition of a costs sanction could force interested persons, and particularly the financially distressed borrower, to consent to foreclosure rather than take the risk of incurring a financial penalty by refusing consent and forcing a sale.

The Commission has been persuaded by the view that the imposition of a costs sanction would do more harm than good. We nevertheless recognize that, in some cases, the lender may have very compelling evidence that a sale will not satisfy the debt, but will only increase the costs. In the following section of this chapter, we shall recommend a judicial foreclosure procedure that could be invoked by a lender in such circumstances.

In some cases, the borrower and the subsequent encumbrancers on whom the notice requesting consent to foreclosure was served may not respond. Should such parties be deemed to have consented to foreclosure in these circumstances?

The Commission has concluded that such a provision is appropriate after the expiry of the proposed delay period; at this juncture, the parties will have had the benefit of the delay period within which to sell the property or make alternate arrangements. Since they have not done so, and in the absence of a response to the lender's notice, we believe that the lender should not be compelled to apply to the court.

Accordingly, the Commission recommends that, after the proposed delay period, the lender should be entitled to serve on the borrower and subsequent encumbrancers the same type of notice requesting consent to foreclosure to which reference has already been made. The same procedure should apply,[269] except that, if the borrower and subsequent encumbrancers do not serve a written objection on the lender within twenty business days of the date on which service of the notice is effective, the borrower and subsequent encumbrancers should be deemed to have consented to the foreclosure.[270]

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[269] *Ibid.*, s. 6.15(1)-(3).

[270] *Ibid.*, s. 6.15(6).

In the event that the borrower or a subsequent encumbrancer did not, in fact, receive the lender's notice, he or she would not be without a remedy. We have provided that, in such cases, the court may set aside the consequences of the person's failure to respond on such terms as are just.[271] Of course, the court would so act only where the applicant could show that the lack of notice caused him or her prejudice. In other words, if the applicant ought to have consented in the first place, the court would not set aside the deemed foreclosure.

(iii) Judicial Foreclosure

As we have indicated, a lender who has been refused consent to foreclosure may have evidence that a sale of the secured property would not realize an amount that would satisfy the debt. There will also be occasions when the best efforts of a lender will be unsuccessful in obtaining an acceptable, or indeed any, offer to purchase the secured property. In these situations, it is clear that some other method of realizing the debt must be made available. Accordingly, the Commission recommends that, where a lender is unable to sell the secured property for an amount that will satisfy the borrower's indebtedness to the lender within three months of the last day of the delay period, or where consent to foreclosure has been refused after the expiry of the delay period and the lender would be unable to sell the secured property for such an amount, the lender should be entitled to apply to the court for an order for foreclosure, that is, to take the property in full satisfaction of the debt.[272] Notice of the application for foreclosure should be served on the borrower and all other persons entitled to the notice of sale. Notice should be served at least ten business days before the application is scheduled to be heard.[273]

In all cases, the borrower will have had a minimum of four months to sell the property before the lender is entitled to take control of the sale.[274] Where the lender's application to the court is on the ground that consent to foreclosure has been unreasonably refused and the lender would be unable to sell the property for an amount sufficient to satisfy the debt, the court, in its discretion, would be entitled to find that, in the case before it, it was commercially reasonable for the lender to take no steps toward sale of the property. Where the court comes to this conclusion, it can make an order of foreclosure.[275] On the other hand, the court would be entitled to refuse an application for foreclosure where it is satisfied that, having regard to all the circumstances, the lender should be required to make efforts to sell the property.

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[271] *Ibid.*, s. 7.1(15).

[272] *Ibid.*, s. 6.16(1).

[273] *Ibid.*, s. 6.16(2). See *supra*, this ch., sec. 6(b)(ii), respecting the persons on whom the notice of sale must be served.

[274] See *supra*, this ch., secs. 6(b)(i)-(iii).

[275] Draft Act, s. 6.16(1) and (3).

Where the lender's application to the court is on the ground that the lender has been unable to sell the property within three months after the last day of the delay period, the court would consider whether all commercially reasonable steps have been taken to sell the property.

(iv) Effect of Foreclosure

Since a security agreement no longer involves a transfer of legal title,[276] title must be transferred to the lender where there has been a foreclosure. The Commission recommends that, in the case of either foreclosure by consent[277] or judicial foreclosure,[278] a certificate of foreclosure should be completed. The certificate of foreclosure should be in a form prescribed by regulation.[279]

Upon registration of the certificate of foreclosure in the appropriate land registry office, all subsequent interests in the land, including that of the borrower, should be extinguished.[280] The lender should become the absolute owner of the property[281] and should no longer be accountable to the borrower with respect to the property. The borrower should have no right to reopen the foreclosure on any grounds other than the lender's fraud in obtaining the certificate,[282] and the borrower's liability to the foreclosing lender should be discharged.[283]

Prior to registration, then, the title to the property would remain unaffected by the certificate of foreclosure. In other words, the borrower would continue to have legal title for all purposes and as against all persons, including the lender. In addition, subsequent encumbrancers would retain their interests in the property. The onus should be on the lender to protect himself or herself by registering the certificate on title. This proposed rule is, we believe, consistent with the general trend in Ontario toward requiring interests to be registered on title in order to be effective.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. **The primary remedy for realization of a lender's security should be a modified extra-judicial power of sale.**

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[276] See *supra*, ch. 2, sec. 2(b).

[277] Draft Act, s. 6.15(4)(a).

[278] *Ibid.*, s. 6.16(1).

[279] *Ibid.*

[280] *Ibid.*, s. 6.17(1)(c), (d), and (e).

[281] *Ibid.*, s. 6.17(1)(a).

[282] *Ibid.*, s. 6.17(1)(e).

[283] *Ibid.*, s. 6.17(1)(b).

2. The remedy of judicial sale should be abolished and the lender's right to take the property in satisfaction of the debt, that is, to exercise foreclosure, should be limited to those circumstances proposed in Recommendations 23-31.

3. (1) At any time before the commencement of sale proceedings, the borrower should be entitled to reinstate the agreement, either by paying the arrears that are due or by performing any covenant that is in default.

   (2) For the purpose of reinstatement, arrears should include:

   (a) all amounts that are payable to the lender at the time of payment, but not the accelerated amount that may be triggered by the default itself; and

   (b) any amounts payable by the lender for the reasonable protection of the lender's security, such as taxes, insurance premiums, condominium maintenance fees, and the costs of commercially reasonable repairs, regardless of whether the lender has actually made such payments.

4. The borrower should be afforded a minimum of ten business days, from service of the notice of default, within which to remedy the default, after which the lender should be entitled to commence sale proceedings.

5. If the borrower fails to remedy the default within the proposed ten day minimum period, the lender should be entitled to serve on the borrower a notice of sale, together with a statement of account.

6. The form of the notice of sale should be prescribed by regulation and should specify the date after which the lender intends to take steps to sell the property.

7. The notice of sale and the statement of account should be served on the following persons, other than persons whose interests in the secured property are prior to the interest of the lender:

   (a) where the property is registered under the *Land Titles Act*, every person appearing by the register of title and by the index of executions to have an interest in the property;

   (b) where the property is registered under the *Registry Act*, every person appearing by the abstract index and by the index of writs received for execution by the sheriff of the county or district in which the property is situate to have an interest in the property;

(c) where there is a statutory lien against the property in favour of the Crown or any other public authority and the lender has written notice of the lien, the Crown exercising the power of sale or other public authority claiming the lien;

(d) where the lender has actual notice of any other interest in the property and where such notice has been received prior to the giving of the notice of sale, the person having such interest;

(e) where the property is a matrimonial home within the meaning of Part II of the *Family Law Act, 1986*, the spouse of the borrower unless:

  (i) the spouse has released all rights under Part II of the Act by a separation agreement;

  (ii) a court order has been made releasing the property as a matrimonial home; or

  (iii) the property ceases to be designated as a matrimonial home pursuant to the provisions of the Act; and

(f) the guarantor of the borrower.

8. There should be a period of delay prior to the exercise of the proposed extra-judicial power of sale. The borrower should have a total of four months after default and not less than two months after service of the notice of sale (which period should include the delays proposed in chapter 7, Recommendation 11, and in this chapter, Recommendation 4), in order to reinstate the security agreement, refinance the debt, or sell the property.

9. (1) During the delay period proposed in the preceding recommendation, the lender should be expressly prohibited from taking any steps relating to the exercise of the power of sale, including advertising or listing the property for sale, negotiating a sale, or selling the property.

   (2) The recommendation in paragraph (1) should not affect the lender's right to possession of the property during this period (see chapter 10).

10. The proposed delay period should be uniform for all borrowers and lenders.

11. (1) The delay period prior to the exercise of the extra-judicial power of sale should not be subject to abridgement or exclusion by agreement between the parties at any time prior to service of the notice of sale, but the parties should be free to agree in writing to abridge or exclude the delay period after that time.

(2) The lender and subsequent encumbrancer should be entitled to apply to the court at any time, without notice to the borrower, for leave to sell the secured property immediately.

(3) Having regard to all the circumstances, the court should be empowered to grant leave to exercise the power of sale without notice, or with notice to such persons, in such manner, and within such time as the court considers proper.

(4) The court order referred to in paragraph (3) should be conclusive of the matters determined in the order.

12. The proposed delay period should be fixed and there should be no discretionary power in the court to extend it, except with the consent of the parties.

13. Despite any rule of law or equity, the court should not be entitled to restrain temporarily or permanently the lender's proper exercise of the power of sale, except with the consent of the parties.

14. (1) The standard of care required of a lender in the conduct of a sale should be that of commercially reasonable care, requiring the lender to obtain the highest realizable price possible under existing market conditions, taking account of the fact that the property is being disposed of at a forced sale. This standard should be imposed by statute.

(2) The lender should be entitled to sell the secured property by tender, public sale, private sale, by one or more contracts, as a unit or in parcels, at any time of day and place and on any terms, including sale on credit, but, subject to paragraph (3), every aspect of the sale, including advertising, time of day, place, and terms should be commercially reasonable, having regard to the nature of the secured property and the circumstances of the sale.

(3) In determining whether a sale is reasonable, the exact timing of the sale should not be considered a factor.

15. The lender's duty of care should be owed to all persons who, in the reasonable contemplation of the lender, are likely to be injured by a breach of that duty.

16. (1) The limitation period for an action alleging a breach of the lender's duty of care in the sale of the property should be two years from the date on which the interest of the borrower in the secured property is terminated.

(2) However, the proposed limitation period should not affect the right of any person to raise, at any time, the lender's breach of the duty of care as a defence to an action on the covenant where there is a deficiency (see chapter 9).

17. There should be no change to the existing rule that the onus of establishing a breach of the duty of care rests on the party alleging it.

18. (1) The proposed standard of commercially reasonable care should not be capable of limitation or waiver by any borrower.

(2) However, the parties to a commercial security agreement should be free to define in advance the type of conduct that would satisfy the requisite standard of care in the conduct of a sale, but the agreement between the borrower and lender should not preclude a court from determining the issue whether the lender has, in fact, met the standard of commercial reasonableness.

19. (1) Where a sale is conducted by the lender's agent:

(a) the sale should be carried out in a commercially reasonable manner;

(b) the agent's duty of care should be owed to all persons who, in the reasonable contemplation of the agent, are likely to be injured by a breach of that duty; and

(c) the lender and agent should continue to be jointly and severally liable for any loss or damage caused by the agent's failure to meet the standard of commercially reasonable care.

(2) Where the use of an agent is commercially reasonable, the costs associated with such use should be recoverable by the lender.

(3) However, where an agent is not used, the lender should not be entitled to remuneration for his or her own care and trouble in the sale of the property.

20. The lender should not be entitled to seek directions from the court concerning whether any steps proposed by the lender in the sale of the property meet the standard of commercial reasonableness.

21. (1) Upon sale of the property to a purchaser in good faith and for value, the interest of the lender, borrower, and all persons with a subordinate interest in the secured property should be extinguished.

(2) For the purpose of the extinguishment of such interests, a sale should be considered to have taken place where the lender has accepted a written offer to purchase the property.

(3) Where the sale of the secured property is not completed, all interests that were extinguished upon the acceptance of the written offer should be revived, and the interests should rank in terms of their priorities as at the time of the sale. In addition, the borrower's entitlement to relief from acceleration should be revived.

(4) Where the sale is not completed, the lender should immediately advise the borrower and serve a written notice on any person who was entitled to receive the original notice of sale (see Recommendation 7) that his or her interest has been revived. If the service of the notice of sale has been waived by the court with respect to any person (see Recommendation 11(3)), that person should not be entitled to be served with the subsequent notice that his or her interest in the property has been revived.

22. (1) A borrower should be entitled to relief from the consequences of his or her default at any time between the date of service of the notice of sale and the date on which the borrower's interest is extinguished by the sale or by foreclosure, provided that the borrower pays the arrears due, performs any other covenant breached, pays the amount of any payment made by the lender where the lender has performed a covenant on behalf of the borrower by making a payment to a third party, and reimburses the lender for the costs and expenses that have been reasonably incurred by the lender in exercising his or her rights. This right should not be capable of abridgement or waiver by agreement between the parties.

(2) The right to relief from acceleration following service of a notice of sale should be available only once in every twelve month period, except where the lender otherwise agrees, but this limitation on the availability of relief should not apply with respect to protected borrowers.

23. The remedy of foreclosure should be retained, but modified by the recommendations that follow.

24. (1) Where, after a notice of sale has been served on a borrower, and during the delay period prior to the exercise of the proposed extra-judicial power of sale, it appears that the proceeds of a sale of the secured property would not exceed the lender's debt, the lender should be entitled to send a notice requesting consent to foreclosure.

(2) The notice requesting consent to foreclosure should be in a prescribed form and should be served on the borrower and subsequent encumbrancers.

(3) The lender should include with the notice copies of all appraisals of the property that are in the lender's control or possession and, where the borrower is a protected borrower, should provide the

borrower with a statement, in plain language, specifically describing the consequences of consenting or refraining to consent to foreclosure.

25. (1) Upon service of the notice requesting consent to foreclosure, the borrower or a subsequent encumbrancer should be entitled either to consent or refuse to consent to foreclosure.

(2) Consent to foreclosure should be given in a prescribed form, which should accompany the lender's notice requesting consent.

(3) Consent given by a borrower or subsequent encumbrancer should not be capable of being withdrawn.

26. The borrower or a subsequent encumbrancer should be entitled to refuse to consent to foreclosure by serving a written objection on the lender.

27. During the four month delay period, the borrower or subsequent encumbrancer should be entitled to refuse consent on any ground; after the delay period, it should be possible to refuse consent only where there are reasonable grounds to believe that the proceeds of a sale of the property will exceed the amount owing to the lender who seeks consent.

28. (1) After the proposed delay period, the lender should be entitled to serve on the borrower and subsequent encumbrancers the same type of notice requesting consent to foreclosure as that referred to in Recommendation 24.

(2) The post-notice procedure proposed above should apply, except that, if the borrower and subsequent encumbrancers do not serve a written objection on the lender within twenty business days of the date on which service of the notice is effective, the borrower and subsequent encumbrancers should be deemed to have consented to the foreclosure.

(3) Where the borrower or the subsequent encumbrancer did not receive the lender's notice, and where the lack of notice caused prejudice to him or her, the court should be empowered to set aside the consequences of the person's failure to respond, on such terms as are just.

29. Where a lender is unable to sell the secured property for an amount that will satisfy the borrower's indebtedness to the lender within three months of the last day of the delay period, or where consent to foreclosure has been refused after the expiry of the delay period and the lender would be unable to sell the secured property for such an amount, the lender should be entitled to apply to the court for an order for foreclosure, that is, to take the property in full satisfaction of the debt.

30. Notice of the application for foreclosure should be served on the borrower and all other persons entitled to the notice of sale at least ten business days before the application is scheduled to be heard.

31. (1) In the case of either foreclosure by consent or judicial foreclosure, a certificate of foreclosure should be completed in a form prescribed by regulation.

(2) Upon registration of the certificate of foreclosure in the appropriate land registry office, all subsequent interests in the land, including that of the borrower, should be extinguished. The lender should become the absolute owner of the property and should no longer be accountable to the borrower with respect to the property. The borrower should have no right to reopen the foreclosure on any grounds other than the lender's fraud in obtaining the certificate, and the borrower's liability to the foreclosing lender should be discharged.

CHAPTER 9

THE ACTION ON THE COVENANT

1. PRESENT LAW

When one thinks of a mortgage, attention is normally directed to an agreement by which a lender acquires a security interest in land. But a mortgage also represents a personal debt obligation of the borrower to the lender. As a result, where the borrower defaults, the lender need not necessarily look to the land for repayment; the lender can sue the borrower on the basis of the latter's personal obligation, or covenant, to pay the debt. The importance of the lender's action on the covenant has increased in recent years, largely as a result of a volatile real estate market that has given rise to increased incidents of deficiencies in the satisfaction of the debt after a sale of the property.

A lender who takes security for a debt can, therefore, proceed to judgment on the debt, as though no such security exists; however, if the judgment remains unsatisfied, the lender still enjoys his or her remedies against the secured property, including the exercise of the contractual power of sale, foreclosure, the appointment of a receiver, and payment of rents and tolls.[1] Conversely, a lender can first realize on the security and then, if there is a deficiency, sue the borrower on the personal covenant.[2] Even where a lender has taken absolute title by a final order of foreclosure, the covenant for payment may be enforced, provided that the lender is still in a position to reconvey the property to the borrower. However, by so doing, the lender reopens the order of foreclosure, thereby giving the borrower a renewed right to redeem.[3]

A judgment for any deficiency may be obtained at the time of a judicial sale. Unlike in the case of foreclosure, payment of the deficiency may be required of the borrower even after a judicial sale, notwithstanding the fact that the lender is unable to reconvey the property to the borrower. The rationale for this rule is that the lender's inability to reconvey has arisen from the fault of the borrower.[4]

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[1] *Economic Life Assurance Society v. Usborne*, [1902] A.C. 147.

[2] *Wegg, Prosser v. Evans*, [1894] 2 Q.B. 101, aff'd [1895] 1 Q.B. 108 (C.A.), and *Pegg v. Hobson* (1887), 14 O.R. 272 (H.C.J.).

[3] See, generally, *supra*, ch. 8, secs. 2(a) and 3(a).

[4] Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 444.

The obligation to pay the debt is contractual, and, in the absence of any legislation to the contrary, ordinary common law principles, including privity of contract, apply. Accordingly, at common law, a borrower who transferred his or her interest in the property to a purchaser, without discharging the mortgage, remained liable for the debt obligation unless he or she was released from the obligation by the lender, either expressly or through a particular course of conduct.[5] This rule applied even if the purchaser agreed to assume the mortgage obligations. Upon default by the purchaser, the lender would usually elect to exercise his or her rights against the secured property, by proceeding to sell it or to foreclose, since this was generally the surest avenue of recovery. However, the lender was also entitled to proceed concurrently and independently against the borrower for payment of the debt, unless, as we have said, the lender had released the borrower from the borrower's personal covenant to pay.

No privity of contract exists between the lender and the purchaser of the property from the borrower. Therefore, at common law, while the lender had remedies against the land, he or she had no right to sue the purchaser for payment of the debt, even where the purchaser had covenanted with the borrower to pay the debt and had actually made payments to the lender. A lender had recourse against the purchaser only if the lender had taken an assignment from the borrower of the purchaser's covenant to pay.

Section 19 of the *Mortgages Act*[6] has significantly altered the law in respect of the lender's rights, although it does not alter the borrower's liability to the lender. This provision creates a statutory right in the lender to sue the purchaser of the secured property for payment of the mortgage debt, if the purchaser is obligated to indemnify the borrower.

The indemnity contemplated by section 19 may be either express or implied. As a general rule, unless expressly stipulated otherwise, the transfer of property subject to a mortgage gives rise to an implied obligation in the transferee to indemnify the transferor for any liability incurred to the lender.[7] In the recent decision of *Regional Trust Co. v. Avco Financial Services Ltd.*,[8] the Court went so far as to find an implied covenant of indemnification in circumstances where a second lender had taken a quit claim deed from a borrower. The first lender had subsequently sold the property under the power of sale and had sued the borrower for the deficiency. The Court held that the borrower was entitled to be indemnified for the deficiency by the second lender to whom title had been transferred.

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[5] *Ibid.*, at 298-300 and 443-46.

[6] R.S.O. 1980, c. 296.

[7] *Holmes v. Fagan*, [1935] 4 D.L.R. 69 (S.C.C.), and *National Trust Co. Ltd. v. Fuciarelli* (1980), 30 O.R. (2d) 289 (C.A.).

[8] (1984), 45 O.R. (2d) 89 (H.C.J.).

While section 19 broadens the lender's rights *vis-à-vis* a purchaser of the secured property, in that a lender may sue both the original borrower and the purchaser for payment of the debt, section 19(3) requires that the lender elect against which of the two parties judgment will actually be taken.

It is apparent, then, that although section 19 expands the scope of recovery of the lender to include a remedy against a purchaser who is obligated to indemnify the borrower, there is no correlative reduction or modification of the borrower's contractual obligations. It has been suggested that section 20 of the *Mortgages Act*, which relates only to building mortgages,[9] reflects a more balanced approach. Section 20(2) prohibits an action on the covenant against the original borrower who has conveyed the property to a transferee, if the sale is *bona fide*, if the transferee has agreed to indemnify the borrower, and if more than one year has expired since the date of maturity of the mortgage.

Section 20 appears to have been enacted in response to a particular concern that arose in the building industry during World War II. Builders were apparently successful in persuading the government that section 19 did not go far enough to relieve the borrower from what they argued was the inequitable effect of the strict application of privity of contract. It had been emphasized that, in many instances, the lender had the benefit of an extended relationship with the purchaser, a relationship that was often of much longer standing than that of the lender with the original borrower. They emphasized that the lender had often actually approved the purchaser, although the borrower was not formally relieved of his or her obligation. The Legislature responded by enacting section 20 in respect of building mortgages. For reasons lost in history, it did not see fit to provide similar relief to any other class of borrowers, such as homeowners.

2. THE LAW IN OTHER JURISDICTIONS

(a) SASKATCHEWAN AND ALBERTA

In both Saskatchewan and Alberta, the right of a lender to recover the debt by an action on the covenant has been eliminated by statute: a lender's remedies are limited to recourse against the land.[10] This significant limitation on the lender's rights is best understood in its historical context. The so-called anti-deficiency provisions were passed in Alberta and Saskatchewan during the Depression in the 1930's,[11] undoubtedly in response to the extreme hardship experienced by property owners, particularly in agrarian communities. Alberta subsequently amended the original prohibition of an action on the covenant to allow recovery by lenders against corporations.[12]

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[9] Section 20(1) defines "building mortgage" as "any mortgage made for the purpose of financing the construction of a building".

[10] *Law of Property Act*, R.S.A. 1980, c. L-8, s. 41(1), and *Limitation of Civil Rights Act*, R.S.S. 1978, c. L-16, s. 2(1).

[11] *An Act to amend The Limitation of Civil Rights Act*, S.S. 1934-35, c. 89, s. 4, and *An Act to amend The Judicature Act*, S.A. 1939, c. 85.

(b) BRITISH COLUMBIA

In British Columbia, as in Ontario, a lender has remedies against both the secured property and the borrower on the personal covenant in the mortgage. An action on the covenant will generally be brought with a petition for foreclosure, and judgment on the covenant will generally be granted with the order *nisi* of foreclosure. However, since the courts in British Columbia regard execution of such a judgment during the redemption period to be inconsistent with the right of redemption, the borrower will usually be granted a stay of execution until the expiration of the redemption period.[13]

Where property is purchased subject to a mortgage, the common law rule of privity of contract governs. The original borrower remains liable on the personal covenant for the mortgage debt, unless the lender releases the borrower from his or her liability on the covenant, or the lender and the purchaser substantially alter the mortgage.[14] The purchaser is not liable to the lender on the covenant unless there is an agreement with the lender that the purchaser assumes the obligation.

Section 20 of the British Columbia *Property Law Act*[15] creates an implied covenant of indemnification of the borrower by the purchaser, subject to a contrary intention. However, there is no statutory equivalent to section 19 of the Ontario *Mortgages Act*, which allows a lender to proceed directly against the purchaser for payment of the secured debt. Accordingly, as the law now stands in British Columbia, where property has been conveyed a number of times, indemnity must be sought from each purchaser in the chain of ownership. Serious problems can arise where the chain of indemnity is broken, such as where one of the successive purchasers is insolvent or cannot be located, with the result that the current owner of the property may not be capable of being joined in the action, and therefore may remain immune from liability for any deficiency in payment of the mortgage debt.

In 1985, the Law Reform Commission of British Columbia issued its *Report on Personal Liability Under a Mortgage or Agreement for Sale*,[16] in which a number of reform proposals were made. The Commission recommended that the action on the personal covenant be retained, subject to certain modifications.

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[12] *An Act to Amend The Judicature Act*, S.A. 1946, c. 38. See, now, *Law of Property Act*, R.S.A. 1980, c. L-8, s. 43(1).

[13] *Citadel Life Assurance Co. v. Abacus Cities Ltd.* (1983), 45 B.C.L.R. 138 (S.C.); *IWA and Community Credit Union v. Erickson*, [1983] B.C.D. Civ. 2768-24 (C.A.); and *Bank of Montreal v. Pilling and Pilling* (1984), 54 B.C.L.R. 179 (C.A.).

[14] *Eaton Bay Trust Co. v. Pollon* (1983), 48 B.C.L.R. 341 (S.C.); *Bank of Montreal v. Miedema* (1983), 30 R.P.R. 264 (B.C.S.C.); and *Eaton Bay Trust Co. v. Pearce* (1984), 58 B.C.L.R. 315 (S.C.).

[15] R.S.B.C. 1979, c. 340.

[16] Law Reform Commission of British Columbia, Report No. 84, *Report on Personal Liability Under a Mortgage or Agreement for Sale* (1985) (hereinafter referred to as "B.C. Report").

The Commission recommended that a lender should be entitled to recover any amount due and owing under a mortgage or agreement for sale directly from the current holder of the property, unless the current holder establishes that the person from or through whom his or her right or title was derived was neither obliged to indemnify that person's transferor nor directly liable to the lender.

The Commission further recommended that a person who is liable to the lender on the personal covenant, or who is liable to indemnify another person who is liable to the lender, should be entitled to recover the amount of his or her liability directly from the current holder of the property, unless the current holder of the property establishes that the person from or through whom his or her right or title was derived was neither obliged to indemnify the latter person's transferor nor directly liable to the lender.

Both of these recommendations are subject to the proviso that the current holder of the property should not be liable to pay any amount in excess of the sum he or she would have been required to pay his or her transferor by way of indemnity.[17]

The Commission also made recommendations regarding the duration of liability on the personal covenant. It observed that, often, neither the borrower nor the purchaser from the borrower is aware of his or her respective position regarding liability on the personal covenant, and that the original borrower will frequently transfer the secured property believing that his or her liability is extinguished upon such transfer. The Commission pointed out that the purchaser and the lender often enter into a further agreement upon expiration of the term of the original mortgage, but that unless the purchaser and lender substantially alter the terms of the mortgage, the original borrower is not released from personal liability.

While the Commission acknowledged that a lender has a legitimate concern regarding the creditworthiness of the person who is liable on the personal covenant, it was of the view that the practice adopted by lenders encouraged borrowers to sell property subject to an existing mortgage. At the same time, the practice obscured the need for borrowers to negotiate a release from liability, either at the time of transfer or at the end of the term of the mortgage, when a modification agreement is entered into by the lender with the purchaser.

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[17] The Commission recommended, however, that the statutory right of indemnity under s. 20 of the *Property Law Act*, *supra*, note 15, should be limited in two instances:

(a) where the mortgage or agreement for sale was not credited to the transferee in calculating the consideration for the transfer; and

(b) where the transfer of property was in essence a gift.

B.C. Report, *supra*, note 16, at 20.

The Commission was of the view that three months after the end of the term of the mortgage would be the appropriate time for the termination of the original borrower's liability. At the end of the term, when the loan must be called or a renewal or modification agreement must be entered into, the lender could determine the creditworthiness of the purchaser, and decide either to enter into a new agreement with the purchaser or to call the loan and require the original borrower to satisfy the indebtedness.

Accordingly, the Commission recommended as follows:[18]

> 5. A person who conveys property, subject to a mortgage, should cease to be liable on the personal covenant three months after the expiration of the term of the mortgage unless demand for payment of the sum secured by the mortgage in full is made upon the covenantor within that period, whether or not the mortgage requires the payment of principal and interest at the expiration of the term without demand.
>
> 6. A person who assigns the right to purchase under an agreement for sale should cease to be personally liable three months after the expiration of the term of the agreement for sale, unless demand for payment of the sum secured by the agreement for sale in full is made upon the assignor within that period, whether or not the agreement for sale requires the payment of principal and interest at the expiration of the term without demand.
>
> 7. Where a mortgage or agreement for sale is payable on demand, a person who conveys property subject to it should cease to be personally liable under the mortgage or agreement for sale three months after written notice of the conveyance is given to the mortgagee or vendor by agreement for sale, unless demand for payment of the sum secured by the mortgage or agreement for sale in full is made within that period.

(c) UNITED STATES

Anti-deficiency legislation, similar in intent to that of Alberta and Saskatchewan, was passed in the same decade in a number of American jurisdictions. For example, in 1933, California[19] passed legislation that prohibited any lender from recovering a deficiency after realization on secured property. The California legislation was subsequently amended[20] to restore the right of a lender to recover a deficiency, except where the deficiency arose in respect of a mortgage on a "dwelling for not more than four families", and the dwelling was occupied by the borrower who used the loan to pay for the property, or where a vendor of property financed the purchase of the secured property.

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[18] *Ibid.*, at 26.

[19] Cal. Stats. 1933, c. 642, § 5.

[20] Cal. Stats. 1963, c. 2158, § 1. See, now, Code of Civil Procedure (West's Ann. C.C.P.), § 580b.

Under the Uniform Land Transactions Act,[21] section 3-510 provides that, as a general rule and unless otherwise agreed, the borrower is liable for any deficiency arising from a sale of the secured property. However, no action for a deficiency may be taken if the debtor is a "protected party"[22] and the obligation secured is a "purchase money security interest".

The latter term is not defined. The Comment to section 3-510 makes no specific suggestion regarding the definition, which is apparently left to the decision of individual states. The Comment explains that some states have added to the Act a definition of a "purchase money security interest" that would have the term include both a mortgage given to a vendor of property and a mortgage given to a lender where the loan proceeds are used by the borrower to pay the purchase price of the property. Other states have defined the term to include a vendor take-back mortgage only. However, the Comment suggests that, if the policy of eliminating deficiency actions is sound, it would seem to be equally sound whether the mortgagee is the vendor or whether the mortgagee is a lender furnishing funds to pay a vendor. In any event, it seems clear that, no matter how the term "purchase money security interest" is defined, the anti-deficiency provisions of the Act apply only if the loan is used to purchase the secured property and not if it is used, for instance, to finance the purchase of another asset or to meet any ordinary living or other expenses of the borrower.

3. PROPOSALS FOR REFORM

(a) ACTION ON THE COVENANT: THE GENERAL RULE

The Commission has considered a suggestion that the remedies available to the lender for recovery of the debt should be limited to recourse against the secured property. We have also considered a proposal that the action on the covenant should be abolished with respect to protected borrowers.[23]

On balance, however, while the Commission considers that there should be some changes in respect of the liability of a protected borrower after a transfer of the property, we have not been persuaded that there is sufficient reason to derogate from the lender's present basic right to recover the total debt where the borrower is in default. Accordingly, we do not endorse any proposal that would abolish or restrict the lender's right of action on the covenant, either alone or in conjunction with any remedy against the secured property.

Legislation that would restrict or abolish the lender's contractual right to proceed on the borrower's personal covenant for payment of the debt would relieve the borrower of what would otherwise be his or her legal obligation to repay the entire loan. A statutory prohibition against actions for deficiencies would impose the risk of declining land values on the lender, while allowing the benefit of any appreciation in land values to flow exclusively to the borrower. The fairness of such a policy is highly questionable.

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[21] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

[22] See *supra*, ch. 4, sec. 4(b).

[23] See *supra*, ch. 4.

Moreover, the practical reality is that the prejudice that would result from the abolition or restriction of the action on the covenant would not fall on the lender alone. In all likelihood, legislation of this kind would simply prompt lenders to attempt to obtain the same protection by different means. The impact of such legislation on the residential loan market would undoubtedly be reflected in higher interest rates, as lenders would inevitably pass on to all borrowers the extra costs of individual defaults and deficiencies. Perhaps more seriously, lenders would probably require a higher downpayment or equity ratio in an attempt to prevent the possibility of a deficiency from arising; this requirement might well have the result of excluding many lower income, higher risk borrowers from the home buying market.

Accordingly, subject to the important qualifications discussed in the following sections concerning the liability of a protected borrower who transfers the property to a purchaser who assumes the security agreement, the Commission recommends that a lender should be entitled to exercise the basic contractual right to proceed on the borrower's personal covenant for payment of the debt. Where the lender wishes both to sell the property and to sue the borrower on the covenant, the lender should not be entitled to commence the action on the covenant until a notice of sale has been served on the borrower.[24] Where the lender wishes simply to proceed on the covenant, the lender should be required to serve a notice of default and the statement of claim should not be served until the expiry of ten business days from service of the notice of default.[25]

The proposed *Land Security Act* should include provisions analogous to sections 19 and 20 of the *Mortgages Act*.[26] However, the provision analogous to section 19 should be modified to provide that the lender is entitled not only to sue the original borrower and the purchaser,[27] as section 19 now permits, but also to recover judgment against both of them on the basis of joint and several liability.[28]

We further recommend that there should be a statutory implied right of indemnification of the borrower or transferor of the property by the transferee, subject to an express agreement to the contrary. We believe this statutory right of indemnity would reflect both the practical expectation of the parties and the current state of the common law.[29] We do not believe, however, that such an expectation of indemnification reasonably arises merely because a second lender takes a transfer from a borrower by way of a quit claim deed, although, as we have discussed, such an intention to indemnify was found to exist in a recent Ontario decision.[30] Accordingly, we recommend that, subject to an express agreement to the contrary, the statutory implied right of indemnification should not arise merely upon transfer of the property to a subsequent lender by way of a quit claim from the owner of the property.[31]

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[24] See the draft *Land Security Act* proposed by the Commission (hereinafter referred to as "draft Act"), *infra*, Appendix 1, s. 6.18(1).

[25] *Ibid.*, s. 6.18(2).

[26] *Ibid.*, ss. 6.19 and 6.20.

[27] See, however, the following sections concerning the liability to the lender of the original borrower and the purchaser.

[28] *Ibid.*, s. 6.19.

(b) LIABILITY OF THE ORIGINAL PROTECTED BORROWER AFTER A TRANSFER OF THE PROPERTY

As indicated earlier,[32] under existing law, the borrower remains liable on the covenant for the secured debt after a conveyance of the property, notwithstanding any express or implied agreement by the purchaser to indemnify the borrower. Even years after a sale of the property, and even after several successive transfers, a borrower may be sued on his or her personal covenant to pay the debt. The fact that the lender has received payments from the purchaser, and that the purchaser has had the benefit of the loan, does not alter the borrower's primary responsibility on the covenant.

Economic realities in the 1980's have made the inequity of such continued responsibility more apparent. Fluctuations in the real estate market, coupled with high interest rates, have resulted in increasing incidences of deficiency claims by lenders against borrowers. The borrower has, in turn, often found the right to indemnification by the financially embarrassed purchaser to be a hollow one.

In the Commission's view, in cases involving protected borrowers,[33] there is no reason why a lender should have the benefit of two potential sources of recovery of the debt, simply because the borrower has chosen to transfer the property. The Commission recognizes, of course, that the financial solvency and capacity of the borrower is critical to the lender's decision to make the original loan. However, provided that the purchaser also has a reasonable ability to meet the obligations under the security agreement, we believe that the substitution of the purchaser's liability for that of the original borrower should provide the lender with adequate security.

Indeed, such a structure of legal liability would correspond to the reasonable expectations of the parties, at least to those of the borrower and the purchaser. Upon the purchase of a property and the assumption of an existing security agreement, a purchaser knows that he or she is under a legal obligation to pay someone, and payments are, in fact, made to the lender. After a transfer, the borrower usually moves on to assume new obligations, and generally believes that his or her liability has been extinguished with the last payment. It is often only the lender who is aware that, under the existing legal regime, there are two sources of potential recovery. In some cases, even the lender is surprised by this state of affairs.

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[29] *Ibid.*, s. 3.6. See *supra*, this ch., sec. 1.

[30] See *ibid.*

[31] Draft Act, s. 6.19(2).

[32] See *supra*, this ch., sec. 1.

[33] See *supra*, ch. 4.

By contrast, in commercial transactions, the personal covenant and the identity and individual characteristics of the borrower can be of great, and even primary, significance to the lender in arriving at financing decisions. The variety and complexity of commercial relationships are not subject to the kind of standardized criteria that are used in the more uniform and relatively uncomplicated residential context. In the commercial context, the substitution of one borrower for another may have serious implications for the lender's planning and expectations or the lender's recovery of the debt. For these reasons, we see no justification for altering the law in respect of security agreements involving non-protected borrowers.

The Commission recommends that, where the transaction involves a protected borrower, the original borrower should be relieved of all liability on the personal covenants in the security agreement, if the property is transferred to a person who has been approved, or ought reasonably to have been approved, by the lender.[34]

Where the lender approves the purchaser, not only the original borrower, but also his or her guarantors, should be relieved of any further liability on those covenants of the security agreement that are assumed by the purchaser.[35] We further recommend that, unless a contrary intention is expressed to the lender, the purchaser should be presumed to have assumed liability for all of the borrower's personal covenants in the security agreement, such as the covenant to insure and to repair, and not merely the covenant to pay the debt.[36] However, the borrower and purchaser should remain free to agree that the purchaser is assuming only certain specified covenants; as a result, the borrower would remain liable for those covenants that have not been assumed. In such instances, however, upon a request to the lender for approval, the lender should be advised of this partial assumption.[37]

Finally, we recommend that a purchaser who has been approved by the lender should remain liable to the lender, to the extent described above,[38] until there has been a subsequent transfer of the property, at which time the preceding recommendations concerning the liability of the parties to the sale of the property should apply.

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[34] Draft Act, s. 5.5(9).

[35] *Ibid.*

[36] *Ibid.*

[37] *Ibid.*, s. 5.5(2).

[38] *Ibid.*, s. 6.19(1)(b).

These proposals would provide a mechanism for the termination of a protected borrower's liability as of the date of the transfer of the property. For a number of reasons, subject to what we recommend below, we consider this approach preferable to that of the British Columbia Law Reform Commission, which, it will be recalled, would provide for the termination of the borrower's liability only three months after the maturity of the security agreement. First, termination of the borrower's liability upon transfer would be more consistent with the general expectations of both the borrower and the purchaser, who, as we have noted, usually believe that a transfer extinguishes the original borrower's liability.

Secondly, we believe that the time of the transfer of the property is the reasonable and optimum juncture at which to determine the creditworthiness of the purchaser, a matter of concern to both the original borrower and the lender. Where the purchaser proves not to be creditworthy, and the lender reasonably refuses to approve the assumption, the borrower will be alerted to the possibility that he or she may be held liable with respect to any deficiency in the event of the purchaser's default. In such a case, the borrower may wish to find another purchaser or to make other arrangements to discharge his or her liability under the security agreement.

Nevertheless, while we would reject the view that the borrower should be relieved of liability *only* where the lender has not demanded payment from the borrower within a certain period of time after maturity of the security agreement, we do believe that the principle animating the British Columbia proposal is, in conjunction with our preceding recommendations, a sound one.

In some instances, an unwary borrower may not be advised to request the lender's consent to approval of the purchaser and, accordingly, would remain liable to the lender on his or her personal covenant. We agree with the Law Reform Commission of British Columbia that this is an untenable and unfair position in which to place a protected borrower. Accordingly, we recommend that, in all cases, a protected borrower should be relieved of all liability on his or her personal covenant in the security agreement unless the lender demands from the borrower or his or her guarantor payment of the outstanding amount owing to the lender within six months after maturity of the security agreement.[39] Legislation implementing this recommendation should apply whether the borrower had sought approval of the transfer at the outset (and had been legitimately denied such approval) or for some reason had neglected to do so.

The foregoing recommendations represent, in our view, a fair and reasonable balancing of the interests of both protected borrowers and lenders by combining a mechanism for seeking approval of a purchaser (and thereby relieving the protected borrower of personal liability) with a means of terminating such liability six months after maturity of the security agreement if no action is taken by the lender against the borrower. Where approval has not been sought or where it has been reasonably denied, the lender will have an opportunity at the maturity of the security agreement to call the loan, having regard, for example, to the creditworthiness of the purchaser. Should the lender not make a timely demand on the borrower, we see no reason why the borrower should continue to remain liable on his or her personal covenant in the original security agreement.

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[39] *Ibid.*, s. 5.5(13).

(c) PROCEDURE TO OBTAIN RELIEF

In order to obtain the proposed relief on a transfer of the secured property by a protected borrower, the protected borrower should be required to request that the lender approve the assumption of the security agreement by the purchaser.[40] The request should be in a form prescribed by regulation[41] and should be served on the lender.[42] The lender should be required either to give written approval of the purchaser or to advise the borrower in writing that approval is being withheld, and the reasons for non-approval.[43]

In determining the suitability of the purchaser, the lender should be permitted to make the same kind of inquiry as would reasonably be made in an application for a new secured loan by a protected borrower.[44] A lender should be entitled to withhold approval of a purchaser if, on commercially reasonable grounds, the substitution of the purchaser for the original borrower would materially increase the lender's risk under the security agreement.[45] Since a determination of a borrower's personal creditworthiness is part of every secured transaction, the question of what constitutes commercially reasonable grounds will be well established and understood in case of any dispute.

The lender has already incurred the costs involved in making an inquiry into the suitability of the original borrower. We are of the view that the lender should not be called upon to pay the costs of an inquiry each time the property is sold. If the borrower wishes to transfer the land and be relieved of potential liability, the lender should be reimbursed for these costs. Accordingly, the Commission recommends that the costs of making a reasonable inquiry into the suitability of the purchaser should be paid to the lender by either the original borrower or the purchaser, as they determine between themselves.[46]

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[40] *Ibid.*, s. 5.5(2).

[41] *Ibid.*

[42] *Ibid.*, s. 5.5(3). As to method of service on the lender, see *infra*, ch. 11, sec. 2.

[43] Draft Act, s. 5.5(4)-(7).

[44] *Ibid.*, s. 5.5(4).

[45] *Ibid.*

[46] *Ibid.*, s. 5.5(4) and (5).

The lender's approval or refusal of the purchaser of the secured property should be required to be given to the borrower within ten business days of receipt by the lender of all the information reasonably required for determining the suitability of the purchaser.[47] This will allow the lender sufficient time to assess the information given to him or her concerning the creditworthiness of the purchaser.

(d) EFFECT OF NONAPPROVAL OR A REASONABLE REFUSAL TO APPROVE

Where a lender reasonably withholds approval of a purchaser, or where the original borrower has not sought the lender's approval, the borrower should remain liable on the personal covenants of the security agreement, subject to the proposal made earlier concerning the termination of the borrower's liability subsequent to the maturity of the security agreement.[48]

We have already recommended that, as a general rule, a provision analogous to section 19 of the *Mortgages Act*, allowing the lender to seek recovery from both the borrower and the purchaser, should be incorporated into the proposed *Land Security Act*.[49] Accordingly, a lender would be entitled to enforce the personal covenant to pay the secured debt against both a protected borrower and a purchaser where the purchaser is obliged to indemnify the protected borrower,[50] and where the protected borrower has failed entirely to seek the lender's approval or where the approval has been reasonably withheld.

(e) EFFECT OF AN UNREASONABLE REFUSAL TO APPROVE

If the lender unreasonably withholds approval of the purchaser, we recommend that the original borrower should be entitled to be relieved of liability under the security agreement in one of two ways. The borrower or the purchaser should be entitled to apply to the court to obtain approval of the purchaser and to relieve the borrower from liability under the security agreement.[51] The burden on the borrower or purchaser in such an application should be similar to that of a lessee in the case of an attempted assignment of a residential lease, where the lease provides that consent to an assignment must be obtained but that such consent is not to be unreasonably withheld.[52]

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[47] *Ibid.*, s. 5.5(6)-(8).

[48] See *ibid.*, s. 5.5(9). See, also, *supra*, this ch., sec. 3(b).

[49] See *supra*, this ch., sec. 3(a).

[50] With respect to a statutory implied right of indemnification, see text following note 28, *supra*. Where no such obligation to indemnify exists, the lender would not be entitled to sue the purchaser under s. 19 of the *Mortgages Act* or under our proposed new regime.

With respect to the implied covenant to indemnify the borrower, which may be excluded by contract, see draft Act, s. 3.6.

[51] *Ibid.*, s. 5.5(10).

We believe that the lender's potential liability for costs in an application for court approval will provide sufficient disincentive to withhold approval unreasonably. Nevertheless, where the lender does withhold approval unreasonably, and where the borrower or the purchaser does not wish to apply to the court, as proposed above, the lender's unreasonable refusal to approve a purchaser should constitute a defence to any subsequent action against the borrower on his or her personal covenant in the security agreement.[53]

(f) EFFECT OF THE LENDER'S FAILURE TO RESPOND

It has been suggested that many lenders will not bother to consider any request for approval, since they will know that, if they ignore the request, the time and effort involved in making an application to court will deter many borrowers from seeking judicial approval. The Commission is of the view that such concerns are not well founded. We fully expect that, upon payment of their reasonable costs, the majority of lenders will comply with the statutory obligation and give *bona fide* consideration to the suitability of the purchaser.

However, it is not unlikely that, either intentionally or inadvertently, some lender may not respond to the borrower's request for approval of the purchaser. The Commission has examined two alternative methods of dealing with this potential problem. Legislation could provide that, where the lender fails to respond within the ten day period proposed above, the lender shall be deemed to have approved the purchaser. Alternatively, legislation could provide for a costs sanction where, because of the lender's silence, the borrower is forced to apply to the court to resolve the matter.

The Commission has concluded that the second alternative, requiring a court application, is inappropriate where the borrower is a protected borrower; thus, a deeming provision, as described above, would not be too Draconian in the circumstances, even where the lender's inaction is due to inadvertence. Accordingly, in order to encourage lenders to deal fairly with protected borrowers by responding in a timely fashion, to discourage failures to act for nefarious reasons, and to reduce the incidence of unnecessary litigation, the Commission recommends that, where the lender fails to respond to the protected borrower's request in a timely fashion, as proposed above, the lender should be deemed to have consented to the assumption of the security agreement by the purchaser.[54]

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[52] See, generally, Williams & Rhodes, *Canadian Law of Landlord and Tenant* (5th ed., 1983), § 15:5. Reference should be made to s. 91(3) of the *Landlord and Tenant Act*, R.S.O. 1980, c. 232, which reads:

> 91.-(3) A tenancy agreement may provide that the right of a tenant to assign, sublet or otherwise part with possession of the rented premises is subject to the consent of the landlord, and, where it is so provided, such consent shall not be arbitrarily or unreasonably withheld.

[53] Draft Act, s. 5.5(11).

(g) A TARIFF OF COSTS FOR APPROVAL OF A PURCHASER

In order that the borrower is not subject to unreasonable demands by the lender in respect of the costs of inquiring into the suitability of the purchaser, we recommend that a tariff should be established by regulation to govern such costs, and that the tariff should be subject to revision on a regular basis. We would emphasize, however, that the tariff should not be inflexible or rigid in defining what is allowable. If, in a particular instance, the borrower disputes any unusual or extra costs that the lender maintains had to be incurred in making the necessary inquiries, either party should be entitled to apply to the court to have the reasonableness of such costs determined.[55]

RECOMMENDATIONS

The Commission makes the following recommendations:

1. Subject to the recommendations concerning the liability of a protected borrower who transfers the property to a purchaser who assumes the security agreement, a lender should be entitled to exercise the basic contractual right to proceed on the borrower's personal covenant for payment of the debt, at any time after the notice of sale has been served on the borrower in default (see chapter 8, Recommendation 5).

2. Where the lender wishes both to sell the property and to sue the borrower on the covenant, the lender should not be entitled to commence the action on the covenant until a notice of sale has been served on the borrower. Where the lender wishes simply to proceed on the covenant, the lender should be required to serve a notice of default and the statement of claim should not be served until the expiry of ten business days from service of the notice of default.

3. The proposed *Land Security Act* should include provisions analogous to sections 19 and 20 of the *Mortgages Act*. However, the provision analogous to section 19 should be modified to provide that the lender is entitled not only to sue the original borrower and the purchaser, but also to recover judgment against both of them on the basis of joint and several liability.

4. (1) There should be a statutory implied right of indemnification of the borrower or transferor of the property by the transferee, subject to an express agreement to the contrary.

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[54] *Ibid.*, s. 5.5(8).

[55] *Ibid.*, s. 5.5(5).

(2) Subject to an express agreement to the contrary, the statutory implied right of indemnification should not arise merely upon transfer of the property to a subsequent lender by way of a quit claim from the owner of the property.

5. Where the transaction involves a protected borrower, the original borrower should be relieved of all liability on the personal covenant in the security agreement if the property is transferred to a person who has been approved, or ought reasonably to have been approved, by the lender.

6. (1) Where the lender approves the purchaser, not only the original borrower, but also his or her guarantors, should be relieved of any further liability on those covenants of the security agreement that are assumed by the purchaser.

(2) Unless a contrary intention is expressed to the lender, the purchaser should be presumed to have assumed liability for all of the borrower's personal covenants in the security agreement, such as the covenant to insure and to repair, and not merely the covenant to pay the debt.

(3) However, the borrower and purchaser should remain free to agree that the purchaser is assuming only certain specified covenants, as a result of which the borrower would remain liable for those covenants that have not been assumed. Upon a request to the lender for approval, the lender should be advised of this partial assumption of liability.

(4) A purchaser who has been approved by the lender should remain liable to the lender, to the extent proposed above, until there has been a subsequent transfer of the property, at which time the preceding recommendations concerning the liability of the parties to a sale of the property should apply.

7. In all cases, a protected borrower should be relieved of all liability on his or her personal covenant in the security agreement unless the lender demands from the borrower or his or her guarantor payment of the outstanding amount owing to the lender within six months after maturity of the security agreement, whether or not the borrower had sought approval of the transfer at the outset.

8. In order to obtain relief from liability on a transfer of the secured property by a protected borrower, the protected borrower should be required to request that the lender approve the assumption of the security agreement by the purchaser. The request should be in a form prescribed by regulation and should be served on the lender.

9. The lender should be required either to give written approval of the purchaser or to advise the borrower in writing that approval is being withheld, and the reasons for such non-approval.

10. In determining the suitability of the purchaser, the lender should be permitted to make the same kind of inquiry as would reasonably be made in an application for a new secured loan by a protected borrower. More specifically, the lender should be entitled to withhold approval of a purchaser if, on commercially reasonable grounds, the substitution of the purchaser for the original borrower would materially increase the lender's risk under the security agreement.

11. The costs of making a reasonable inquiry into the suitability of the purchaser should be paid to the lender by either the original borrower or the purchaser, as they determine between themselves.

12. The lender's approval or refusal of the purchaser of the secured property should be required to be given to the borrower within ten business days of receipt by the lender of all the information reasonably required for determining the suitability of the purchaser.

13. Where a lender reasonably withholds approval of a purchaser, or where the original borrower has not sought the lender's approval, the borrower should remain liable on the personal covenants of the security agreement, subject to Recommendation 7.

14. (1) Where the lender unreasonably withholds approval, the borrower or the purchaser should be entitled to apply to the court to obtain approval of the purchaser and to relieve the borrower from liability under the security agreement. The burden on the borrower or the purchaser in such an application should be similar to that of a lessee in the case of an attempted assignment of a residential lease, where the lease provides that consent to an assignment must be obtained but that such consent is not to be unreasonably withheld.

    (2) Where the lender unreasonably withholds approval, and where the borrower or the purchaser does not wish to apply to the court, as recommended in paragraph (1), the lender's unreasonable refusal to approve the purchaser should constitute a defence to any subsequent action against the borrower on his or her personal covenant in the security agreement.

15. Where the lender fails to respond to the protected borrower's request for approval of the purchaser in a timely fashion (see Recommendation 12), the lender should be deemed to have consented to the assumption of the security agreement by the purchaser.

16. A tariff should be established by regulation to govern the costs of inquiring into the suitability of the purchaser, and the tariff should be subject to revision on a regular basis. If, in a particular instance, the

borrower disputes any unusual or extra costs that the lender maintains had to be incurred in making the necessary inquiries, either party should be entitled to apply to the court to have the reasonableness of such costs determined.

CHAPTER 10

POSSESSION OF SECURED PROPERTY

1. RIGHTS TO POSSESSION BY BORROWERS AND LENDERS

(a) EXISTING LAW

In the absence of a provision to the contrary in the mortgage, a lender is entitled to possession of the secured property. At common law, this right was not dependent on default by the borrower; rather, it flowed from the estate or interest conveyed to the lender by the mortgage.[1] Although, as we have said, a security agreement no longer involves a transfer of title, section 6(3) of the *Land Registration Reform Act, 1984*,[2] provides that the borrower and lender "are entitled to all the legal and equitable rights and remedies that would be available to them if the [borrower] had transferred the land to the [lender] by way of mortgage, subject to a proviso for redemption". Accordingly, subject to a contrary agreement, the lender is entitled to possession of the property at any time after the security agreement is entered into.

It is, however, the almost invariable practice in Ontario to provide in the mortgage that the borrower will have possession of the secured property until default with respect to either payment of the debt or the performance of another contractual obligation.[3] Upon such default, the lender is usually entitled to enter the secured property without notice or demand.

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[1] *Four-Maids, Ltd. v. Dudley Marshall (Properties), Ltd.*, [1957] Ch. 317, [1957] 2 All E.R. 35. See *supra*, ch. 2, sec. 1(a).

[2] S.O. 1984, c. 32. The Commission has recommended the repeal of s. 6(3): see *supra*, ch. 2, sec. 4(b). With respect to the abolition of a transfer of title, see *Land Registration Reform Act, 1984*, s. 6(1), and *supra*, ch. 2, sec. 2(b).

[3] See *Short Forms of Mortgages Act*, R.S.O. 1980, c. 474, Schedule B, para. 16; see, also, paras. 6 and 7, relating to the lender's right to possession on default. The Act was amended by the *Land Registration Reform Act, 1984*, *supra*, note 2, s. 24. The effect of the amendment is to render the *Short Forms of Mortgages Act* inapplicable to future mortgages in Ontario.

Under existing law, a lender may claim possession in an action for foreclosure[4] or judicial sale,[5] or the lender may take possession extra-judicially. While there is no legal obligation to obtain a writ of possession,[6] a lender will not ordinarily take possession without a writ, unless the borrower either consents to such action or has abandoned the secured property. The reason that lenders usually seek the court's *imprimatur* prior to enforcing their right to take possession is that the taking of possession by force, even where the lender's right to possession is undisputed, may constitute a criminal offence under section 73(1) of the *Criminal Code*.[7]

A writ of possession pursuant to Rule 60.10 of the Rules of Civil Procedure[8] will issue only with leave of the court and upon proof of service of the writ on all persons in actual possession of the land.[9] The material to be filed by the lender on an application for a writ must identify all persons in physical possession of the land, and the nature of their possession, and must provide sufficient information regarding their relationship with the lender to allow the court to determine the priority of the various claims to possession.

As a general rule, the court has no discretion to refuse leave to issue a writ of possession on the ground of hardship. Nor, in the case of a final judgment in a mortgage action, does the court have any jurisdiction to stay the enforcement of the judgment on the ground of hardship.[10] However, it has been suggested that, under Rule 567(2) of the former Rules of Practice,[11] a person with an interest subordinate to that of the lender, such as a tenant, may have a right to apply to the court in order to obtain time to vacate the premises rather than be turned out, and that, in such a case, hardship may well be a relevant factor.[12]

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[4] Rules of Civil Procedure, O. Reg. 560/84, r. 64.03(5)(b).

[5] *Ibid.*, r. 64.04(4)(b).

[6] *Ibid.*, r. 60.10, respecting writs of possession.

[7] Section 73(1) of the *Criminal Code*, R.S.C. 1970, c. C-34, provides:

> 73.-(1) A person commits forcible entry when he enters real property that is in actual and peaceable possession of another in a manner that is likely to cause a breach of the peace or reasonable apprehension of a breach of the peace, whether or not he is entitled to enter.

An anomaly exists in respect of the criminal sanction and the lender's civil right in that, once having taken possession, a lender is entitled to retain possession even if his conduct in taking possession constituted a criminal offence. A lender's entitlement to possession may also constitute a defence to a civil action for trespass to the person by the borrower. See *Lusk v. Perrin* (1920), 19 O.W.N. 58 (H.C.Div.), and *Hemmings v. The Stoke Poges Golf Club*, [1920] 1 K.B. 720 (C.A.).

[8] *Supra*, note 4.

[9] *Ibid.*, r. 60.10(2).

[10] *Canada Trust Co. v. McLean* (1983), 143 D.L.R. (3d) 101 (Ont. H.C.J.).

[11] R.R.O. 1980, Reg. 540.

[12] *Canada Trust Co. v. McLean*, *supra*, note 10, at 104-05.

On occasion, borrowers have attempted to avoid this general rule by resorting to procedural delays, making an application for adjournment, rather than for a stay of enforcement. The issue whether an application for a writ of possession may be adjourned on the basis of hardship has not been completely resolved. In *Canada Trust Co. v. McLean*,[13] the Court considered the relevant English jurisprudence, particularly the case of *Birmingham Citizens Permanent Building Society v. Caunt*.[14]

In the latter case, Russell J. observed that the right of possession was an important part of a lender's security and that equity could never legitimately destroy or suspend that right. Accordingly, he held that the Court had no jurisdiction either to decline to make an order for possession or to adjourn the proceedings indefinitely.

In the *Canada Trust Co.* case, Potts J. expressed the view that the *Caunt* decision denied jurisdiction in the court to adjourn proceedings for possession. However, the rule in *Caunt* does not appear to be quite so clear. While holding that no indefinite adjournment could be granted, the Court in *Caunt* did suggest that an application might be adjourned for a "short time" to give the borrower a chance to pay the lender, where there existed a "reasonable prospect" that the borrower could satisfy the lender's claim.

There remains some question whether the court has even the limited jurisdiction contemplated by Russell J. in *Caunt*. It is certainly arguable that the court's jurisdiction to adjourn proceedings is based on the inherent and necessary power of the court to control its own procedure and is not an aspect of the court's equitable jurisdiction.[15] Accordingly, hardship would not be a relevant factor in determining whether the proceedings should be adjourned. However, this issue has yet to be directly addressed in Ontario, and the possibility that a court may be sympathetic to an application based on a claim of hardship can be anticipated from the following observation of Potts J. in the *Canada Trust Co.* case:[16]

> It appears to me that there are equally good reasons for the court to possess a power to stay proceedings [on] the ground of undue hardship. In the current economic recession, the real estate market depressed, with many homes being lost through default and being placed on the market, further depressing it, it may be very doubtful if the lender obtains any real improvement of his position by enforcing his rights. At the same time, the mortgagor can suffer great hardship out of all proportion to the mortgagee's advantages.

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[13] *Ibid.*, at 110.

[14] [1962] 1 Ch. 883.

[15] Ryder, "The Legal Mortgagee and His Right to Possession" (1969), 22 Cur. Leg. Prob. 129.

[16] *Supra*, note 10, at 112.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

Although a mortgage is essentially security for a debt, a borrower's right to possession of the secured property is defined exclusively by the terms of the security agreement. In the absence of a clause granting possession to the borrower, the lender is entitled to have possession of the secured property. As we have seen, this right arose at common law as an incident of the transfer of title to the lender as security for the debt, and has been retained by section 6(3) of the *Land Registration Reform Act, 1984* notwithstanding the abolition of the transfer of title under section 6(1) of that Act.

Even where the borrower is entitled by contract to possession, that right typically terminates upon default. While it is not the practice of most lenders to do so, a lender is entitled to seek an order for possession immediately upon default by the borrower. As we have discussed,[17] such an application appears not to be subject to a stay or adjournment on the ground of hardship. A borrower may be evicted immediately from the secured property without any opportunity to find suitable alternative accommodation. Moreover, the cost and disruption of moving, or the mere prospect of having to move on virtually no notice, may undermine any efforts of a borrower to put his or her affairs in order and remedy the default.

Where the mortgage transaction involves commercial parties and commercial property, the parties, almost always advised by legal counsel, can be expected to negotiate such matters as possessory rights at the outset of their relationship. There can be many reasons why a lender will want to go into possession immediately upon default by a commercial borrower, particularly where the lender is entitled to collect revenue from the property or wishes to ensure that the property is maintained as a viable commercial operation. The commercial borrower may well receive some financial or other *quid pro quo* for acceding to such a right. However, a borrower who occupies the secured property as a residence may suffer considerable hardship from immediate dispossession, a hardship normally shared by others, such as members of the borrower's family, who live in the premises.

(c) THE LAW IN OTHER JURISDICTIONS

(i) Canadian Torrens Jurisdictions

In the Western provinces, where the Torrens system of land registration is used, a borrower does not convey title to the lender. Accordingly, the right to possession does not flow to the lender upon execution of the mortgage. The lender's right to possession at any time prior to taking title by means of foreclosure is limited to that which is expressly provided for by statute or contract.

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[17] See *supra*, this ch., sec. 1(a).

In Alberta and Saskatchewan, an action for possession may be taken by a lender immediately upon the borrower's default. In Manitoba, an action for possession may not be taken until the default has continued for one month.[18]

(ii) United States

In the United States, the issue of a lender's right to possession has been determined by questions of title and has resulted in complex rules that differ from jurisdiction to jurisdiction. The different rules arise from the fact that there are three theories of American mortgage law.[19] Under the "title theory", the lender takes a conveyance of the legal estate and, in the absence of a contractual term stipulating otherwise, the lender's right to possession automatically flows with the title. Under the "lien theory", the lender's claim is merely to a lien against the land. There is no transfer of title and the borrower retains the right of possession until a sale of the property or a foreclosure after default. In what is called the "intermediate theory", title is transferred to the lender, but the borrower's right to possession is secure from the outset and the lender becomes entitled to possession only after the borrower's default. The complexity of mortgage law, or laws, that resulted from these various theories led to the adoption of Article III of the Uniform Land Transactions Act.[20] Article III was intended to reform and rationalize mortgage law generally, including the rules pertaining to the right to possession.

Section 3-502 of the Act governs the right to possession by a lender. Section 3-502(a) provides that, upon the borrower's default, the lender may take possession by civil action. The Comment to the section points out that this is a substantial change in the law of the "lien theory" states, and that section 3-502(a) adopts the result that follows theoretically in "title theory" and "intermediate theory" states, that is, that the lender can take possession upon default and need not wait until foreclosure or sale. The Comment also emphasizes that, where the Act is not in effect, resort has been frequently had to a court appointed receiver to remove the borrower from possession, because, for example, the lender has no right to possession before foreclosure or sale to himself or herself. The Comment explains that it is in furtherance of a major policy goal of the Act, namely, to reduce the cost of foreclosure by eliminating the need for the intervention of the expensive receivership process, that the right to possession by the secured creditor after default has been provided.

There can be no self-help or extra-judicial taking of possession under the Act, which, as we have said, has retained the rule that possession must be taken through judicial process in a civil action. The Comment explains that, since taking possession of land without the debtor's consent would be a breach of the peace, or at least a trespass, in many jurisdictions, judicial process is required to legitimize possession without consent.

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[18] *Real Property Act*, R.S.M. 1980, c. R30, s. 108(1); *Land Titles Act*, R.S.S. 1978, c. L-5, s. 196(1); and *Land Titles Act*, R.S.A. 1980, c. L-5, s. 173(1)(a).

[19] See, generally, Osborne, *Handbook on the Law of Mortgages* (2d ed., 1970), at 32.

[20] National Conference of Commissioners on Uniform State Laws, Uniform Land Transactions Act, Uniform Laws Annotated, Vol. 13.

The Act makes no specific provision for cases of abandonment of the secured property by the borrower. The Comment acknowleges that a speedy response may be necessary to protect the property from vandalism. The Comment observes, however, that a lender is entitled to make an application for relief to the court, which has the power to use *ex parte* or show cause procedures to prevent the commission of waste. This power was considered to be adequate to deal with the issue of abandonment. The Comment emphasizes that the mere absence by the debtor may be ambiguous and, therefore, independent scrutiny by a court regarding abandonment is necessary.

Section 3-502(e) of the Act creates an exception to the general rule governing the right of possession by a lender. If the secured property is occupied as a residence by a "protected party",[21] the lender has no right to take possession until the property is sold to him or her.[22] The court is obliged to stay the execution of any order for possession until the protected party's interest has been terminated either by judicial or extra-judicial sale.[23] Under section 3-502(f), the court retains a discretion under the Act to allow earlier possession by the lender only if it is necessary to protect the property against deterioration or destruction.

(d) PROPOSALS FOR REFORM

(i) Introduction

As we have discussed,[24] at common law, the lender's right to possession was an incident of the transfer of title under the security agreement. Under the *Land Registration Reform Act, 1984*,[25] the requirement of a transfer of title has been abolished with respect to all security agreements, which, regardless of their form, constitute merely a charge against the secured property. Accordingly, any proposal that the right to possession should remain in the borrower after execution of the security agreement would be consistent with the borrower's retention of title. It would also coincide with the general expectations of the parties to a security agreement, and particularly with the expectation of borrowers who occupy the secured property as a residence. However, section 6(3) of the *Land Registration Reform Act, 1984*, which provides that despite section 6(1), the lender and borrower are entitled to all the legal and equitable rights that would be available to them if there had been a transfer, preserves the lender's right to possession prior to default. We believe that this should no longer be the rule.

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[21] The definition of "protected party", in § 1-203(a), is reproduced *supra*, ch. 4, sec. 4.

[22] With respect to foreclosure, see *supra*, ch. 8, sec. 5(a)(iii)b.

[23] Time limitations in respect of any action by a lender in the sale of the property are discussed *supra*, ch. 8, sec. 5(b)(ii)b.

[24] See *supra*, this ch., sec. 1(a).

[25] *Supra*, note 2.

A lender generally requires possession of the secured property only after a default by the borrower. Possession by the lender is usually needed for one of two reasons: it may be required in order to facilitate a sale of the property, or in order to protect the property from waste or destruction. Occasionally, parties to a commercial transaction may also contemplate other circumstances, either before or after default, where the lender should be entitled to have possession of the secured property. For example, a lender may require possession in order to collect revenue from the property or to ensure that the property is maintained as a viable commercial operation. In the Commission's view, issues respecting entitlement to possession differ, depending on whether the transaction involves a protected borrower or a non-protected borrower. Accordingly, we shall make separate recommendations with respect to these two classes of borrowers.

(ii) The Non-Protected Borrower's Right to Possession

We regard the existing rule, which gives the lender a right to possession prior to default unless the mortgage provides otherwise, to be inconsistent with a central thrust of this Report, that is, that the lender's interest in the secured property is merely as security for the debt. We believe that, subject to a proposal made in the following paragraph, a borrower who is not a protected borrower should be entitled to retain possession of the secured property until there has been a default under the agreement, and we so recommend. Upon default, the lender should be entitled to take possession of the secured property.[26]

While we are of the view that possession by the non-protected borrower should be the general rule, we recognize that the parties to a security agreement may contemplate circumstances in which the lender should be entitled to take possession even prior to a default. The parties may also wish to agree that there will be a period of time after a default during which the borrower should be entitled to remain in possession, in order to arrange for alternative premises and an orderly move. Accordingly, we recommend that, in transactions that do not involve protected borrowers, the parties should be entitled to contract out of the general rule and to establish, either before or after default, their own rules governing rights to possession of the secured property.[27]

(iii) The Protected Borrower's Right to Possession

We are acutely aware of the disruptive impact that dispossession has on protected borrowers and their families, particularly where the secured property is residential premises. As we have discussed, the cost and emotional strain involved in finding, and moving to, alternative accommodation can itself prevent such a borrower from making the effort necessary to remedy the default. As a result, we are of the view that a protected borrower should not be subject to dispossession any earlier than is necessary to protect the lender's legitimate interests.

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[26] See the draft *Land Security Act* proposed by the Commission (hereinafter referred to as "draft Act"), *infra*, Appendix 1, s. 6.21(1).

[27] *Ibid.*

We have recommended earlier that there should be a minimum four month period after default by any borrower, during which time the lender would be prohibited from taking steps in the exercise of the proposed extra-judicial power of sale.[28] We have also recommended that a protected borrower should not be able to waive or limit the rights conferred by this proposal at any time prior to service of the notice of sale on the borrower, although a court, upon application by the lender, may abridge the delay period where it is satisfied that the normal delay would be detrimental to interested parties.[29] These recommendations are intended to allow a borrower time either to reinstate the security agreement, refinance, or make efforts to sell the property. Since the property cannot be placed for sale by the lender during this four month period, the lender has no need of possession, unless, as we shall consider in the following section, the borrower has abandoned the secured property, thereby jeopardizing the lender's security.

Accordingly, we recommend that, where the borrower is a protected borrower, the lender should not be entitled to take possession of the secured property until the proposed minimum four month delay period has expired,[30] subject to the exceptions discussed below. The lender should be required to obtain a writ of possession and should be entitled to the writ at any time after default, but the writ should not be effective until the expiry of the four month delay period.[31] The protected borrower should be advised of the right to remain in possession during the delay period, and this advice should be included as part of the notice of default to be served on the borrower, as earlier recommended.[32]

We believe that this proposed possessory right is of the utmost importance to protected borrowers and their families. Accordingly, we recommend that, subject to one exception, any term of the security agreement, or any collateral agreement entered into, that purports to waive or limit a protected borrower's right to possession until expiration of the proposed delay period, should be void and unenforceable.[33] At the early stage when the security agreement is executed, the protected borrower may not appreciate the gravity and implications of a waiver or limitation of the proposed possessory rights.

We recognize, however, that there may be circumstances where, for sound reasons, a protected borrower will want to give up possession after service of the notice of sale, in order to allow the lender to conduct an immediate sale of the secured property.[34] At this late juncture, the borrower may recognize that there is little or no chance of salvaging his or her financial affairs or selling the property privately. We recommend, therefore, that a protected borrower should be entitled to consent to possession by the lender, provided that such consent is in writing and has not been sought or given until after service of the notice of sale.[35]

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[28] See *supra*, ch. 8, sec. 6(b)(iii).

[29] See *supra*, ch. 8, sec. 6(b)(v).

[30] Draft Act, s. 6.21(2).

[31] *Ibid.*

[32] See *supra*, ch. 8, sec. 6(b)(i). With respect to service, see *infra*, ch. 11, sec. 2. Concerning what must be set out in the notice of default, see draft Act, s. 6.3(3).

[33] *Ibid.*, s. 2.5.

(iv) The Lender's Right to Possession of Residential Property Prior to Expiry of the Delay Period

Occasionally, a borrower who sees little hope of remedying his or her default and saving the property will simply abandon the property or otherwise leave it open to vandalism, destruction, and general waste. We believe that, as a matter of policy, a lender should not be forced to accept this deteriorating state of affairs without a remedy. It is only fair that, under these circumstances, prior to the expiry of the delay period, the lender should be entitled to take possession of property. Two means of proceeding are contemplated, one involving the obtaining of a writ of possession from the court, the other involving extra-judicial possession taken by a lender.

With respect to judicially sanctioned possession, essentially in cases of emergency, we recommend that a lender should be entitled at any time to apply to the court for leave to issue a writ of possession without notice to the borrower.[36] Among the circumstances that should be considered by the court in such an application should be the abandonment or apparent abandonment of the secured property by the borrower and the commission, or the failure to prevent the occurrence, of waste of the secured property.[37] The court should be empowered, having regard to the circumstances, to grant leave to issue the writ of possession without notice or with such notice to such persons, in such manner, and within such time as the court considers proper.[38]

Where the property has been or appears to have been abandoned by the borrower, it may not be realistic to expect the lender to obtain possession, and thereby safeguard his or her interests, by applying to the court for a writ of possession, even though the application may be made without notice to the borrower. While we do not endorse recourse to extra-judicial possession in as wide a range of cases as that envisaged for possession under a writ of possession, we do recommend that, prior to the expiry of the waiting period, the lender should be entitled to take possession of property that has been or appears to have been abandoned.[39]

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[34] We have recommended that, after service of the notice of sale, the borrower and lender should be free to abridge or waive the proposed delay period before sale: see *supra*, ch. 8, sec. 6(b)(v)a.

[35] Draft Act, s. 6.21(5).

[36] *Ibid.*, s. 6.22(1).

[37] *Ibid.*, s. 6.22(3).

[38] *Ibid.*, s. 6.22(2).

The difficulty that may arise for the lender is in determining whether the property has, in fact, been abandoned. As a general principle, real property has been abandoned in law where a person has vacated the property with the intention of not returning. However, a person's intention is a notoriously difficult fact to establish. Even such conduct as the acquisition of another residence may not constitute evidence of abandonment, if, for example, such acquisition is merely of a temporary character.[40]

We believe that lenders should be given some fair and objective guidelines in order that they can act with confidence in taking possession prior to the expiration of the delay period. Accordingly, we recommend that a lender should be entitled to presume that the property has been abandoned where all reasonably available evidence, including the condition of the property, would lead a reasonable person to believe that the borrower has vacated the property and does not intend to return. The lender should be required to make reasonable inquiries in order to obtain such evidence and, more particularly, to determine whether the borrower's absence is of a temporary or permanent nature.[41]

The Commission is aware that, even where the lender has acted in good faith and has made reasonable inquiries, a borrower may not have actually intended to relinquish his or her possessory rights by abandoning the property. Given the possibility that the borrower did not abandon the property, great care must be taken to alert a borrower that the lender intends to take possession. We recommend that a notice of the lender's intention to take possession of the property should be served on the borrower in the manner recommended later in this Report.[42] The lender should also be required to post a notice on the property, stating that the lender intends to take possession, in order that a returning borrower may be made aware of any proceedings that have taken place in his or her absence.[43] Once having made reasonable inquiries and having given or posted the requisite notice, the lender should be entitled to take possession of the property.

If the borrower did not intend to abandon the property, he or she should be entitled to retake possession immediately.[44] A lender who has taken possession without reasonable belief that the property has been abandoned, or without having complied with the procedural safeguards proposed above, should be liable for any actual damage suffered by the borrower. Where, however, the lender has acted reasonably in assuming the property was abandoned, the lender should not be liable to the borrower, notwithstanding that the lender was in error in taking possession.[45] We believe that this proposal strikes a fair balance between the legitimate interests of lenders to safeguard their security, and the rights of borrowers to retain possession of their property unless and until that security is being jeopardized.

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[39] *Ibid.*, s. 6.23(1).

[40] *Re Hetherington* (1910), 14 W.L.R. 529 (Sask. Dist. Ct.).

[41] Draft Act, s. 6.23(3)(b).

[42] See *infra*, ch. 11, sec. 2.

[43] Draft Act, s. 6.23(2).

[44] *Ibid.*, s. 6.23(3)(a).

(v) Abandoned Chattels

Upon taking possession of the secured property, a lender will often find chattels that have been left by the borrower. Most often, these chattels, such as old furniture or clothing, have been intentionally abandoned by the borrower and have little or no commercial value. A lender will naturally want to dispose of such items when preparing the property for sale.

Occasionally, the abandoned chattels have some obvious value that could be recovered through a sale. For example, the lender may find relatively new household appliances, such as a stove or a dishwasher, on residential premises, or machinery on commercial premises. It has been suggested that the lender should be entitled to sell such chattels and apply the proceeds against the secured debt.

The issue concerning what the lender should be entitled to do with chattels left on the secured property by the borrower raises several distinct questions. First, has the borrower intentionally abandoned the chattels, or have they been left inadvertently on the property? Secondly, what disposition should the lender be entitled to make of the chattels in either case? And thirdly, how should the law protect a third party who has or may have an interest in the chattels? For example, there is a possibility that abandoned chattels may be subject to a personal property security interest. The third party is likely to have protected its priority of interest in the chattels by registering the security agreement pursuant to the *Personal Property Security Act*.[46]

We turn first to consider the question of the status of chattels left on the property. How can the lender be assured that the chattels have been abandoned? How is the borrower to be alerted to the fact that he has left chattels on the property and must claim them immediately?

At the time the lender takes possession, the borrower will already have received a notice of default from the lender. We have recommended that the notice of default should set out, in plain language, the rights and remedies of the lender and the borrower on default.[47] One of the rights and remedies of the lender would be the entitlement to deal with chattels left or abandoned on the property, as proposed below.

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[45] *Ibid.*, s. 6.23(3)(b).

[46] R.S.O. 1980, c. 375.

[47] See *supra*, ch. 8, sec. 6(b)(i), and draft Act, s. 6.3(3)(b).

But, as we have said, there may be persons, other than the borrower, who have or may have an interest in the abandoned chattels. In order that the interest of such a person is not prejudiced by a sale of the chattels by the lender, we recommend that, where the lender takes possession of the secured property and finds chattels on that property, the lender should be required to conduct such searches as may be appropriate in the circumstances against the name of the borrower, of motor vehicles for which permits have been issued under the *Highway Traffic Act*,[48] and of the individual debtor index, business debtor index, or motor vehicle index established under the *Personal Property Security Act*.[49]

We further recommend that, where it appears to the lender, from a search or otherwise, that a person has or may have an interest in any of the abandoned chattels, the lender should be required to give notice in writing to such person that the lender has taken possession of the chattels. Such a person should be required to make a claim to the chattels within fifteen business days after notice in writing has been received.[50]

Where a person makes a claim to an interest in the abandoned chattels, either as a result of, or independently of, the lender's notice, and the lender believes on reasonable grounds that that person's claim is valid, the lender should be required to permit such person to take possession of the chattels. Where the lender does so, the lender should incur no liability to the borrower, the true owner of the chattels, or any person having an interest in the chattels.[51]

In some instances, the lender may be uncertain as to the validity of a claim to abandoned chattels. Either the lender or the claimant may wish to have the matter resolved in court. Accordingly, we recommend that a lender or a claimant should be entitled to apply to the court in order to determine the validity of any claim made to an interest in chattels abandoned on the secured property.[52]

Where the lender believes, on reasonable grounds, that no person other than the borrower has an interest in any of the abandoned chattels, or where a person who has received the lender's notice does not respond to the notice within fifteen business days after receipt, the lender should be entitled to sell or otherwise dispose of the chattels by any commercially reasonable method, without liability to the borrower, the true owner of the chattels, or any other person having an interest in the chattels.[53]

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[48] R.S.O. 1980, c. 198, Part II.

[49] Draft Act, s. 6.24(1).

[50] *Ibid.*, s. 6.24(2)-(3).

[51] *Ibid.*, s. 6.24(10).

[52] *Ibid.*, s. 6.24(6).

[53] *Ibid.*, s. 6.24(3).

Where the lender so disposes of abandoned chattels that are subject to a personal property security interest or are owned by a person other than the borrower, to a person who acquires them in good faith, the rights of the secured party or true owner in respect of the property or any proceeds thereof should be extinguished. The lender should be able to sell the chattels free of such rights.[54] And, as we have proposed, the lender should not be liable — for example, in trespass or conversion — simply because of the disposition of the chattels. The lender would be liable only where the lender disposes of the chattels to the prejudice of a person, other than the borrower, who the lender reasonably believes has or may have an interest in the property and where that person has not, in fact, been served with the lender's notice, as recommended above.[55] In this last-mentioned situation, the lender could have protected himself or herself by sending the proposed notice to the third party and by waiting the requisite fifteen days before acting.

Where a third party's rights in the chattels have been extinguished, a question arises as to what recourse that party has. Clearly, where the third party had a security interest in the chattels, he or she would retain the right to sue the borrower for the outstanding balance on the debt. One alternative would be to immunize the lender from all liability and compel the third party to seek redress from the borrower, if that is possible. However, as we shall see below, a lender who sells the chattels or appropriates them for his or her own use would be permitted to apply the proceeds of sale, or the value of the chattels, to pay his or her reasonable expenses and then to pay the debt. Consequently, the lender would obtain a benefit from the sale or use of the abandoned chattels. We believe that it is only fair that, in such a case, the lender should be obligated to account to any person who had an interest in the chattels. The lender should be required to account up to the amount of the proceeds of sale, or the value of the chattels if the lender has kept them, after deducting the reasonable expenses incurred in selling the chattels or otherwise lawfully dealing with them.[56]

Where the lender disposes of chattels by sale, the proceeds of disposition should be applied first to pay the lender's reasonable expenses in disposing of the chattels. These expenses should include the expenses of processing or preparing the chattels for sale. The balance of any proceeds of the sale of the chattels should be distributed as part of the proceeds of the sale of the secured property.[57]

(vi) Postponement of Possession

As we have seen, while there seems to be no general jurisdiction in the court to postpone or adjourn the lender's taking of possession on the ground of the borrower's hardship, the courts have occasionally been moved to mitigate the rigour of this principle by granting borrowers short adjournments, exercising the court's inherent jurisdiction to control its own procedure.[58] Although the validity of such an exercise of discretion is doubtful and has been criticized, the motivation for such intervention is, we believe, understandable. As discussed, a borrower can be dispossessed immediately after default, without any opportunity to make efforts either to remedy the default, and remain in possession, or to find suitable alternative accommodation.

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[54] *Ibid.*, s. 6.24(4) and (5).

[55] *Ibid.*, s. 6.24(3).

[56] *Ibid.*, s. 6.24(9).

[57] *Ibid.*, s. 6.24(8). The distribution of proceeds is dealt with *ibid.*, ss. 6.13-6.14.

We believe that the harshness that has motivated the occasional interference of a sympathetic court has been addressed by our earlier recommendation that a reasonable period of time should be provided a protected borrower so that he or she may either remedy the default or make arrangements to relocate, without having to surrender possession of the property. The Commission considers the creation of a minimum four month delay period to be a fair and reasonable balancing of the needs of the borrower and the interests of the lender.[59] Accordingly, as we indicated above with respect to the exercise of the power of sale,[60] it is the Commission's view that a line must be fixed and that the lender should not be met with applications for further delay at the end of the proposed delay period. If the borrower has not remedied the default by the end of the four month waiting period, the lender should be entitled to vacant possession without further delay. We therefore recommend that there should be no jurisdiction in the court to postpone the lender's right of possession, or adjourn any proceedings instituted in respect of that right, beyond the proposed four month delay period.[61]

2. THE DUTY AND STANDARD OF CARE OF A LENDER IN POSSESSION

(a) EXISTING LAW

As we have discussed, in the absence of a term to the contrary in the mortgage, a lender is entitled to take possession of the mortgaged property. While equity did not interfere with the lender's common law right to possession, a lender was not entitled to deal with the property without regard for the borrower's beneficial interest. Equity took the view that the lender assumed the responsibilities of proper management of property that had been taken out of the hands of the borrower.[62]

The obligations of a lender in possession are based on the equitable notion that the mortgage is merely security for the debt, so that the lender is not entitled to obtain any benefit other than the debt due. A lender is under a duty to account for the management of the property not only to the borrower but also to subsequent encumbrancers and all other persons claiming under the borrower.[63] Once having taken possession, a lender cannot be relieved of the obligations without the consent of the borrower.[64]

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[58] See *supra*, this ch., sec. 1(a).

[59] See *supra*, ch. 8, sec. 6(b)(iii).

[60] See *supra*, ch. 8, sec. 6(b)(vi).

[61] Draft Act, s. 7.4.

[62] See, generally, Rayner and McLaren (eds.), *Falconbridge on Mortgages* (4th ed., 1977) (hereinafter referred to as "Falconbridge"), at 643-58.

As with the standard of care required of a lender in the conduct of sale,[65] the standard that a lender in possession must satisfy is not entirely clear. On the one hand, commentators have observed that, with respect to the duty to collect rents and profits, a lender must manage the secured property as a person of ordinary prudence would manage his or her own.[66] On the other hand, authorities have said that, in making repairs, the lender in possession is not to be judged by the standard of care applicable where a person is managing his or her own property.[67]

As part of the duty to manage the secured property, a lender in possession is accountable for rents and profits in two different ways. First, a lender is liable to pay occupation rent if in actual occupation of the property, using it in place of a tenant.[68] Rule 55.04(1)(c) of the Rules of Civil Procedure[69] provides that the referee may make an allowance for occupation rent at the time of the taking of accounts after a sale.

Secondly, a lender in possession is under an obligation to account for, and to use due diligence to recover, rents and profits from the property. Rule 55.04(1)(b) reflects the common law requirement that the lender must account for rents and profits actually received or that, but for the lender's wilful neglect or default, might have been received.[70] Therefore, where a lender evicts a tenant who otherwise wishes to remain and pay rent, the lender may be liable for rents from the date of eviction.[71] Similarly, the lender may be held liable for refusal to rent to a new tenant or to accept higher rent from an existing tenant.[72] If the premises become vacant, the lender is expected to use such ordinary means as any owner of property would adopt to make the vacancy known, although it has been said that the lender "is not bound to procure tenants at all hazards, or pay the rent himself if the premises be vacant".[73]

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[63] *Halsbury's Laws of England* (4th ed., 1980), Vol. 32, para. 699, at 318.

[64] *In re Prytherch* (1889), 42 Ch. D. 590, at 599-60, and *Lusk v. Perrin* (1920), 19 O.W.N. 58 (H.C. Div.).

[65] See *supra*, ch. 8, sec. 3(c)(iii).

[66] Falconbridge, *supra*, note 62, at 651.

[67] Fisher and Lightwood (ed. Tyler), *Law of Mortgages* (9th ed., 1977) (hereinafter referred to as "Fisher and Lightwood"), at 351.

[68] *Lambert v. MacKenzie*, [1950] 1 D.L.R. 178 (Ont. C.A.), at 182, citing *Coldwell v. Hall* (1862), 9 Gr. 110, at 112.

[69] *Supra*, note 4.

[70] *Halsbury's Laws of England*, *supra*, note 63, Vol. 32, para. 698, at 317-18; *Rennie v. Block* (1896), 26 S.C.R. 356; *McHugh v. Union Bank* (1913), 10 D.L.R. 562, [1913] A.C. 299 (P.C.); *Re Allen's Danforth Theatre*, [1925] 4 D.L.R. 556, 7 C.B.R. 87 (Ont. S.C. in Bank.); and *Coldwell v. Hall*, *supra*, note 68.

[71] *Penn v. Lockwood* (1850), 1 Gr. 547.

[72] *Merriam v. Cronk* (1874), 21 Gr. 60, at 64-65.

Given the right of a borrower to redeem the secured property,[74] equity requires that a lender in possession be in a position to return the property unimpaired upon redemption. Accordingly, the lender is liable for permitting waste and deterioration of the property. Indeed, any person having an interest in the property is entitled to bring an action to enjoin such conduct.[75] The lender in possession is not, however, responsible for deterioration of the property that is merely due to the passage of time.[76]

Related to the lender's obligation to prevent waste is the obligation to make necessary repairs to the property. In addition to the implication of this rule in relation to the borrower's right to redeem, as noted above, the rule is designed to protect a borrower and subsequent encumbrancer against any depreciation in the sale value of the property arising from the lender's failure to make such repairs. The rule also has implications for third parties who may be injured due to the lack of repair of the property.

Rule 55.04(1)(d) of the Rules of Civil Procedure[77] permits the referee, on the taking of accounts, to "take into account necessary repairs, lasting improvements, costs and other expenses properly incurred". But it seems that the lender may make ordinary repairs only; the lender is not entitled to undertake major improvements to the property without the concurrence of the borrower, either express or implied. The cost of unauthorized improvements will not be recoverable on the taking of accounts if they have impaired the borrower's ability to redeem the property.[78]

Some dispute exists concerning the proper fund from which to pay for such repairs. Some have suggested that the source is the surplus rents, after payment of the amount owed to the lender in respect of the mortgage debt;[79] others have said that the lender must first apply the rents to the repairs.[80]

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[73] *Coldwell v. Hall*, *supra*, note 68, at 114.

[74] See *supra*, ch. 8, secs. 2(a) and 3(a).

[75] Falconbridge, *supra*, note 62, at 656, and *Halsbury's Laws of England*, *supra*, note 63, Vol. 32, para. 704, at 233.

[76] *Wragg v. Denham* (1836), 2 Y. & C. Ex. 117, 160 E.R. 335.

[77] *Supra*, note 4.

[78] *Halsbury's Laws of England*, *supra*, note 63, Vol. 32, para. 703, at 322.

[79] Falconbridge, *supra*, note 62, at 656.

[80] Fisher and Lightwood, *supra*, note 67, at 352.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

In our view, the standard of care of a lender in possession is ambiguous and offers few meaningful guidelines for the parties. The absence of clearcut guidelines affects both those, like the borrower and subsequent encumbrancers, who have an interest in the property, and third parties who may enter on the property and suffer injury because of the deteriorating condition of that property. We believe that the standard of care should be clearly established by legislation.

(c) THE LAW IN THE UNITED STATES

Section 3-504 of the Uniform Land Transactions Act[81] imposes an obligation on a lender in possession to manage the property "as would a prudent man, taking into account the effect of his management on the interest of the debtor". The Act enumerates specific statutory duties of a lender in possession, including the duty to obtain reasonable casualty and liability insurance, to maintain the property "in at least as good condition as existed at the time the creditor took possession", and to apply receipts to the payment of ordinary operating expenses, including royalties, rents, and other expenses of management. The Act also empowers a lender to make other repairs and improvements necessary to comply with building, housing, and other similar codes.[82]

A different formulation of the standard of care is that required of a secured party by section 9-207(1) of the American Uniform Commercial Code,[83] which requires that "reasonable care" must be taken in the custody and preservation of personal property in the possession of the secured party. American courts have held that the liability of a secured creditor in possession, imposed by the Code, is based on principles of negligence in the context of property law, that is, bailment and pledge, rather than on principles of contract.[84] Privity of contract is not necessary in order to establish liability for loss; accordingly, third parties have a right of action for loss caused by the negligence of a secured party in possession.

There are no specific duties enumerated in the Code formulation of "reasonable care". However, the American common law relating to pledges has interpreted "reasonable care" by considering all the circumstances of the pledge and the character of the secured property.[85] Section 9-207(2)(b) of the Code provides that the risk of loss or damage is on the debtor, to the extent of any deficiency in any insurance coverage, unless the loss is due to the secured party's failure to take reasonable care.[86] However, American courts have inferred from the statutory duty of care a duty on the secured party to insure against loss or destruction.[87]

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[81] *Supra*, note 20.

[82] *Ibid.*, § 3-504(d)(3).

[83] National Conference of Commissioners on Uniform State Laws, Uniform Commercial Code, Uniform Laws Annotated, Vol. 3. The Ontario *Personal Property Security Act*, *supra*, note 46, s. 19, has adopted essentially the same provisions with respect to the standard of "reasonable care".

[84] *Grace v. Sterling, Grace & Co.*, 289 N.Y. Supp. 2d 632 (App. Div. 1968).

[85] Hoenig, "Duty of a Pledgee" (1969), 10 B.C.L. Rev. 301.

(d) PROPOSALS FOR REFORM

(i) Introduction

From our earlier discussion, it should be clear that the standard of care of a lender in possession is, to a large extent, uncertain. In our view, it is essential that the standard of care be clearly established. In formulating an appropriate standard, we believe that several factors must be considered.

The first is that a lender almost always prefers to receive the payments due under the agreement, and does not want to be forced to exercise his or her remedies on the borrower's default. The lender has not chosen to take possession; rather, it is the borrower's default that has necessitated this action.

The second factor that must be considered is that the nature of the relationship of the borrower and the lender is primarily a commercial one, even where the secured property is residential. They are debtor and creditor, and the appropriate standard of care of a lender in possession should reflect this fact.

Finally, the appropriate standard must be sufficiently flexible to be applied to many types of secured property. The management of a single family residence obviously differs from that of a large commercial development.

(ii) The Proposed Standard of Care

In determining the appropriate standard of care to be required of a lender in possession of secured property, the Commission has sought to devise a standard that reflects the commercial nature of the relationship between the parties, while ensuring that the interests of the borrower and subsequent encumbrancers are not prejudiced by the lender's control of the property. As with the standard required of a lender in the conduct of a sale of the property,[88] the Commission has considered a spectrum of possible standards.

We have concluded and, accordingly, recommend that the appropriate standard of care for a lender in the custody and preservation of secured property in the lender's possession should be the same as that which we have recommended for a lender in the conduct of a sale, that is, the standard of commercially reasonable care, having regard to the nature of the secured property.[89] We propose the term "commercially" reasonable care in this context in order to emphasize both the essentially debtor-creditor nature of the secured transaction and the necessity of considering the customary commercial conduct that should be expected of a reasonable lender in dealing with property of a particular kind. In addition, the standard of "reasonable" care of a lender in possession is one with which the courts are already familiar in the context of pledges,[90] and that has been adopted in Ontario in the *Personal Property Security Act*.[91]

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[86] Uniform Commercial Code, *supra*, note 83, § 9-207(2)(b) and (3).

[87] *Dubman v. North Shore Bank*, 271 N.W. 2d 148 (Wis. Ct. App. 1978).

[88] See *supra*, ch. 8, sec. 6(b)(viii).

[89] Draft Act, s. 6.30(1).

We further recommend that, where the lender in possession employs an agent to manage secured property, the duty and standard of care of the agent should be the same as that of the lender. Accordingly, the agent would be required to use commercially reasonable care in the management of the secured property.[92] Moreover, we recommend that there should be no change to the existing rule that a lender is liable for the acts of the agent, pursuant to the common law principles of agency.[93]

To satisfy the proposed standard of commercially reasonable care, the lender or the lender's agent would be required to do whatever was usual or customary in order to maintain the value, usefulness, and condition of the property, having regard to the interests of the borrower, subsequent encumbrancers, and others who may be affected by a breach of the proposed standard, and to the nature and condition of the property. The cost of such maintenance should be borne by the borrower and, therefore, added to the debt.[94]

In order to ensure that a borrower or a person having an interest in the property will receive the property back, upon redemption, in the same state as it was when the lender took possession, we recommend that the borrower or any person having an interest in the property should continue to be entitled to apply to the court to enjoin a lender or a lender's agent whose actual or expected standard of conduct in the care of the property fails, or will fail, to meet the proposed standard.

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[90] *Miadovnik v. Szasz*, [1955] O.W.N. 556 (H.C.J.).

[91] *Supra*, note 46.

[92] Draft Act, s. 6.30(1).

[93] See, generally, Fridman, *Law of Agency* (5th ed., 1983).

In this connection, see § 3-504(c) of the Uniform Land Transactions Act, *supra*, note 20, which relieves a lender of responsibility for the acts of his or her agent in the management of the property, provided that the agent is (1) in the business of managing real estate of the kind involved, (2) financially responsible, (3) not related to the lender, and (4) prudently selected. This is a significant change in the common law.

The Comment to § 3-504(c) indicates that this choice was based on a desire to alter the usual recourse of lenders to the costly procedure for the judicial appointment of a receiver, a trend that had resulted from the equivocal state of the law regarding the obligations of a lender in possession. The implementation of § 3-504(c) was expected to reduce the use of judicially appointed receivers and encourage instead the employment of prudently chosen agents. It was intended that, in his or her economic self-interest, a lender would prefer to control the selection of experts rather than have the selection made by a judge, perhaps without due regard to the competence of the chosen agent in managing property of that kind. It was also thought that the resulting reduction of costs would be a benefit to all parties.

[94] Draft Act, s. 6.13(1)(a).

(iii) Specifying the Duties

As with the standard of care in the conduct of sale,[95] the Commission has considered whether the statutory formulation of the standard should specify some or all of the duties of a lender in possession that would satisfy the proposed standard. For example, the American Uniform Land Transactions Act[96] enumerates several specific requirements.[97]

On balance, we do not believe that specific duties should be enumerated in the statute with respect to the conduct of a lender in possession. The proposed standard has been chosen for its inherent flexibility, so that regard may be had to the nature of the particular property and the circumstances of the transaction. We believe that any enumeration of specific duties could not be exhaustive. Moreover, such a list might lead to a mechanical and, therefore, insufficient compliance by a lender, rather than encourage a thoughtful consideration of what constitutes reasonable care with respect to possession of a particular property.

(iv) Persons to Whom the Lender's Duty of Care is Owed

The Commission has already made recommendations concerning the standard of care imposed on a lender in possession of the secured property. In proposing the standard of commercially reasonable care, we have adopted essentially negligence principles.[98]

The requirement on the lender to exercise commercially reasonable care while in possession has two main aspects. First, the lender's duty is to ensure that the value or condition of the secured property is not diminished by his or her conduct. This duty affects those persons, such as the borrower and subsequent encumbrancers, who have an interest in the property, either in respect of their rights of redemption or their rights upon a sale of the property.

Secondly, the duty to act in a commercially reasonable manner is imposed to ensure that third parties, who may have no interest in the property, are not injured because of the neglected condition of that property, where that condition arises from the lender's failure to meet the proposed standard of care.

The Commission attaches equal importance to both facets of the lender's duty to exercise commercially reasonable care while in control of the secured property. Accordingly, we recommend that, if the lender or the lender's agent fails to comply with the proposed standard, the lender and the lender's agent should be jointly and severally liable for any loss or damage caused to any person, including the borrower, subsequent encumbrancers, and guarantors, who, in the reasonable contemplation of the lender or the lender's agent, might suffer such loss or damage.[99] In other words, the rule concerning the persons to whom the lender's duty is owed would be established on the basis of negligence principles.

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[95] See *supra*, ch. 8, sec. 6(b)(viii).

[96] *Supra*, note 20.

[97] See *supra*, this ch., sec. 2(c).

[98] See *supra*, this ch., sec. 2(d)(ii). With respect to the standard of care imposed on a lender in the exercise of a power of sale, see *supra*, ch. 8, sec. 6(b)(viii).

(v) Indemnification of a Borrower

We recommend that, if a borrower is held liable for wrongdoing for which the lender in possession is responsible, the borrower should be entitled to indemnification by the lender.[100] For example, the borrower, as registered owner of the land, may be sued successfully by a person injured on the secured property for breach of the owner's duty to keep the property in repair. In such a case, the borrower should be entitled to indemnification from the lender, if it was commercially reasonable for the lender in possession to have made the repair in question.

(vi) Waiver or Limitation of the Standard of Care

As in the context of the standard of care in the conduct of a sale,[101] we have considered whether the standard of care should be capable of waiver or limitation by the borrower. The Commission has had no difficulty coming to the firm conclusion that, as a matter of principle, there can be no justification for a lender avoiding the standard of commercial reasonableness. Moreover, the protections afforded by this standard benefit not only the borrower, but all persons having an interest in, or entering on, the secured property. The rights of these persons should not be subject to diminishment by an agreement between the borrower and the lender. Accordingly, we recommend that the proposed standard of commercially reasonable care to be exercised by a lender in possession should not be capable of being waived or limited by the borrower, whether or not he or she is a protected borrower.[102]

Nevertheless, as with a sale of the secured property,[103] we recognize that the variables and complexities involved in the management of some properties may make it reasonable for the parties to agree in advance as to what constitutes commercially reasonable care. We therefore recommend that the parties to a transaction that does not involve a protected borrower should be entitled to define, in advance, the conduct required of a lender in possession in order to satisfy the standard of commercial reasonableness.[104]

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[99] Draft Act, s. 6.30(2).

[100] *Ibid.*, s. 6.30(3).

[101] See *supra*, ch. 8, sec. 6(b)(xiii).

[102] Draft Act, s. 2.5.

[103] See *supra*, ch. 8, sec. 6(b)(xiii).

[104] Draft Act, s. 6.30(4) and (5).

However, we believe that such an agreement should constitute a guide only, and that the sufficiency of the agreed conduct should be open to dispute by any interested person. Accordingly, we recommend that, upon the application of any person who is affected by the issue whether the standard of commercial reasonableness has been satisfied, the court should be empowered to determine the issue, notwithstanding that such conduct conforms to the terms agreed upon by the borrower and the lender.[105]

3. A LENDER'S CLAIM TO EXPENSES, REMUNERATION AND COSTS OF AN AGENT

(a) EXISTING LAW

(i) Expenses

A lender in possession is entitled to claim expenses actually incurred in the management of the property as part of the total debt to be paid by the borrower, either upon redemption or upon sale of the property.[106] These expenses include money spent in the collection of rents and profits, in the preservation of the property from destruction forfeiture, or sale,[107] and the legal costs to support the borrower's title to the property in an action brought by another person.

A lender in possession is also entitled to be reimbursed for expenses incurred in fulfilling the duty to repair the secured property.[108] However, as we have seen, the lender is not entitled to make substantial repairs or improvements to the property without the concurrence of the borrower, since in so doing the lender may impair the borrower's ability to redeem the property. For instance, if a portion of the roof is leaking, the lender is under a duty to have the roof repaired. However, it would be unreasonable for the lender to have the entire roof replaced with expensive slate tile where the additional cost of such an improvement, added to the borrower's debt to the lender, would make it impossible for the borrower to obtain refinancing and, therefore, to redeem the property. In the case of a substantial improvement without consent, the borrower, who wants to redeem the secured property by paying the debt, would be required to pay only the amount that would have been reasonably incurred in the repair of the roof, even though the value of the property has been increased by the lender's conduct.

Where, however, a substantial improvement that increases the value of the property has been made and the property is sold, so that the borrower obtains the benefit of the improvement in the price obtained upon sale, the lender will generally be allowed to recover the expenditure for the improvement.[109] Therefore, in the example given above, if the the slate roof was considered to be a substantial improvement that was not reasonable for the lender to have made in the circumstances, but the borrower had not been prevented from redeeming the property as a result, and the property is sold for an increased amount that could be attributed to the slate roof, the lender would be entitled to be reimbursed for the actual amount of the expenditure.

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[105] *Ibid.*, s. 6.30(7).

[106] Falconbridge, *supra*, note 62, at 648-50, and Fisher and Lightwood, *supra*, note 67, at 351-53. For the power of the referee to take into account "costs and other expenses properly incurred", see r. 55.04(1)(d) of the Rules of Civil Procedure, *supra*, note 4, discussed in text accompanying notes 77-80, *supra*.

[107] For example, to prevent a sale for tax arrears.

[108] See r. 55.04(1)(d) and *supra*, note 106.

(ii) Remuneration of the Lender and Costs of an Agent

As we have said earlier, a lender is not entitled to remuneration for his or her personal time and care in managing the property or collecting rents.[110] An anomaly exists in respect of this rule, in that, although a lender cannot claim for his or her own time and trouble in the care of the property, the lender may be entitled to recover the reasonable costs of employing an agent in the management of the property. As a result, a lender may be inclined to appoint an agent whenever possible. However, it bears emphasizing that it is not a matter of course that a lender is entitled to recover the costs of an agent; rather, an agent may be employed where it would not be reasonable to expect the lender to manage the property.[111]

In determining whether the appointment of an agent is reasonable, the nature of the property must be considered. In *Sokolosky v. Robinson*,[112] the Court was satisfied that the use and costs of an agent were reasonable, having regard to the fact that "a great deal of time and attention was necessary" and that "the detail associated with the management was very considerable".[113]

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

In general, we are of the view that the entitlement of a lender in possession to reimbursement for necessary expenses in the management of the property raises few difficulties. Lenders, however, have expressed a wish for some clarification with respect to their liability for substantial improvements, emphasizing that occasionally the line between what consititutes a "repair" and what consitututes an "improvement" can be vague. They also have suggested that the rule prohibiting remuneration for a lender's time and trouble in the management of the secured property is anomalous in light of the fact that they can recover the reasonable cost of employing an agent to do the same task.

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[109] *Sandon v. Hooper* (1843), 6 Beav. 246, 49 E.R. 280 (Rolls); *Shepard v. Jones* (1882), 21 Ch.D. 469 (C.A.) *Henderson v. Astwood*, [1894] A.C. 150 (P.C.); and *Laws et ux. v. Toronto General Trusts Corp.* (1904), 8 O.L.R. 522 (Div. Ct.).

[110] *Eyre v. Hughes* (1876), 2 Ch.D. 148, and *Igloo Refrigeration Co. Ltd. v. Industrial Acceptance Corp. Ltd.*, [1943] O.W.N. 604 (H.C.J.), at 607.

[111] *Union Bank of London v. Ingram* (1880), 16 Ch. D. 53, at 56-57.

[112] [1943] O.W.N. 398 (H.C.J.).

[113] *Ibid.*, at 400.

(c) PROPOSALS FOR REFORM

(i) Expenses

We are of the view that there should be no change in the present law with respect to the lender's right to recover reasonable expenses in the management of the secured property. However, in order to clarify the law with respect to reimbursement for repairs, the Commission recommends that the lender should be entitled to recover moneys spent in the repair of the property, provided that the expenditure is commercially reasonable in the circumstances.[114] We recognize that the existing distinction between a necessary repair and a substantial improvement can be unclear and the source of some debate between the parties. Accordingly, we further recommend that the borrower, the lender, or any interested person should be entitled to apply to the court for a determination whether a proposed expenditure or an expenditure already incurred is or was commercially reasonable and, therefore, recoverable by the lender.[115]

(ii) Remuneration of the Lender for the Management of the Property

The time that a lender may spend, and the trouble he may have, in the management of the property can occasionally be considerable. We are of the view that the rule prohibiting a lender from claiming remuneration for such a task, but allowing recovery of the costs of an agent fulfilling the same duties, is anomalous. Accordingly, we recommend that a lender should be entitled to claim, as part of the expenses of possession, reasonable compensation for his or her own care and trouble in fulfilling necessary duties in the management of the secured property.[116]

The parties should be free to agree in advance regarding what constitutes reasonable compensation for the lender's services. However, the lender should be entitled to no greater compensation than is reasonable in the circumstances and the agreed amount should be subject to challenge in court by any interested person.[117]

(iii) Recovery of the Costs of an Agent

We recommend that there should be no change to the existing law that allows a lender to recover the costs of employing an agent where it was commercially reasonable to do so.[118] As with the lender's remuneration, the reasonableness of the costs of an agent should be capable of being challenged in court by any interested person.[119]

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[114] Draft Act, ss. 6.30(6), 6.14, and 6.13(1)(a).

[115] *Ibid.*, ss. 6.30(7) and 6.13(3).

[116] *Ibid.*, s. 6.30(6)(a).

[117] *Ibid.*, ss. 6.30(7) and 6.13(3).

[118] *Ibid.*, ss. 6.30(6)(b) and 6.13(1)(a).

[119] *Ibid.*, ss. 6.30(7) and 6.13(3).

4. THE LENDER'S POSSESSION OF LEASED PROPERTY

(a) PRESENT LAW

(i) Introduction

In many cases, secured property, particularly commercial property, will not be occupied directly by the borrower; rather, it will be leased by the borrower to a third party. Where the borrower-landlord defaults in his or her obligation under the security agreement, the lender may want to take possession of the leased property for several reasons. As discussed below, the lender may be compelled to take possession in order to obtain rents from the tenant, which will be applied to discharge the secured debt. Or the lender may want to obtain vacant possession in order to facilitate a sale of the property, or in order to give possession to a new tenant who is willing to enter into an agreement that is more favourable to the lender.

A lender's right to possession of secured property that has been leased by the borrower depends on whether the lease legally binds the lender.[120] A lease will bind a lender in two instances: first, where the tenancy arises prior to the mortgage, in which case the mortgage binds only the reversion; and, secondly, where the lease, although executed after the mortgage, is made with the lender's express or implied consent. Where a mortgage contains a power to lease, the lender will be deemed to consent to a subsequent lease and will therefore be bound by it. In either case, at common law a lender who had gone into possession of the secured property had no right to evict the borrower's tenant until the termination of the lease.[121]

(ii) Binding Tenancies

Where a lease binds a lender, the lender is entitled to payment of the rent that becomes payable by the tenant after the borrower's default, so long as the lender has notified the tenant of the default and has demanded payment of the rent.[122] By making such a demand for rent, the lender steps into the shoes of the borrower and, at least at common law, assumes the obligations of a landlord, as well as those of a lender in possession, in the proper care and management of the property.

An unresolved question for both the lender and the tenant is whether, and if so, when, Part IV of the *Landlord and Tenant Act*,[123] relating to residential tenancies, governs the rights and obligations of a lender in possession of secured property subject to a binding tenancy. Section 1(b) of the Act defines

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[120] See, generally, Falconbridge, *supra*, note 62, at 320-28, and *Halsbury's Laws of England*, *supra*, note 63, Vol. 32, paras. 615-30, at 282-90.

[121] *Davidson v. McKay* (1867), 26 U.C.Q.B. 306; *Canada Permanent Building and Savings Society v. Rowell* (1860), 19 U.C.Q.B. 124; and *District Bank, Ltd. v. Webb*, [1958] 1 All E.R. 126 (Ch.).

[122] Falconbridge, *supra*, note 62, at 324.

[123] R.S.O. 1980, c. 232.

"landlord" as including a "lessor, owner, the person giving or permitting the occupation of the premises in question, and his heirs and their heirs and assigns and legal representatives, and in Parts II and III also includes the person entitled to possession of the premises". On its face, the definition of "landlord" would not appear to include a "person entitled to possession of the premises" for the purpose of Part IV of the Act.

In *Re Pajelle Investments Ltd. and Booth*,[124] dealing with this issue, the Court held that the definition of landlord in the Act is inclusive rather than exclusive. The landlord and tenant relationship described in section 3 of the Act was broadly interpreted.[125] The Court held that it was a matter of fact whether a lender in possession and a tenant occupied substantially the position of landlord and tenant for the purpose of the Act. Unfortunately, there was no discussion of the relevant indicia in making such a determination, so that neither lenders nor tenants have any clear direction as to their rights or remedies under the Act.

Although the lender in possession under a binding tenancy is entitled to rent payable after the borrower's default, the lender is not entitled to claim any arrears of rent owing for the period prior to default by the borrower under the mortgage, unless such arrears are expressly assigned to the lender.[126]

It has been suggested[127] that the question of proportional entitlement with respect to rent for the period after default, but prior to notice to the tenant, may be affected by section 3 of the *Apportionment Act*,[128] which provides:

> 3. All rents, annuities, dividends, and other periodical payments in the nature of income, whether reserved or made payable under an instrument in writing or otherwise, shall, like interest on money lent, be considered as accruing from day to day, and are apportionable in respect of time accordingly.

It appears that the effect of this provision is that the lender is entitled to rent only in respect of the period after the lender becomes entitled to possession and that becomes payable since the giving of notice, or, though payable before notice, is in fact unpaid when the notice is given.[129]

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[124] (1974), 6 O.R. (2d) 181 (H.C.J.).

[125] Section 3 provides:

> 3. The relation of landlord and tenant does not depend on tenure, and a reversion in the lessor is not necessary in order to create the relation of landlord and tenant, or to make applicable the incidents by law belonging to that relation; nor is it necessary, in order to give a landlord the right of distress, that there is an agreement for that purpose between the parties.

[126] *Salmon v. Dean* (1851), 3 Mac. & G. 344, 42 E.R. 293 (Ch.).

[127] Falconbridge, *supra*, note 62, at 324.

[128] R.S.O. 1980, c. 23.

[129] Falconbridge, *supra*, note 62, at 324.

(iii) Non-Binding Tenancies

If a tenancy arises after the mortgage is granted and without the lender's consent, the lender's right to take possession upon the borrower's default is paramount to the rights of the tenant. Upon taking possession, the lender can immediately eject the tenant.[130] If the lender leaves the tenant in possession, and in the absence of an assignment of the right to the rent by the borrower, the lender is not entitled to obtain such rent from the tenant except by creating a new tenancy and assuming the obligations of a landlord. A lender's conduct in demanding, receiving, or distraining for rent, or giving notice to quit, will be taken as creating a new tenancy on the terms of the existing lease.[131] Where a new tenancy is created in this manner, there arises the same unresolved issue concerning the applicability of Part IV of the *Landlord and Tenant Act* that we discussed in the last section in the context of binding tenancies.

As a result, a lender who does not wish to assume the obligations of a landlord, or who requires vacant possession at some time prior to the end of the term of the lease in order to exercise the power of sale, ordinarily will eject the tenant immediately. However, the decision to eject a tenant may give rise to liability to the borrower for breach of the duties of a lender in possession, which includes the duty to obtain rents and profits.[132]

A tenant can be placed in a difficult position where a dispute arises between a borrower and lender regarding entitlement to rent. If a tenant continues to pay rent to the borrower after the latter's default and after receipt of the lender's notice demanding rent, and is later compelled to pay such rent to the lender, the tenant is not entitled in law to recover the rent mistakenly paid to the borrower.[133] Similarly, a tenant who pays rent to a lender on the mistaken assumption that the lender is legally entitled to receive such rent is not entitled to recover the amounts paid should it later be determined that the lender was not entitled to the money.[134] If there is a court action between the parties, such as in the case of foreclosure, the tenant can simply pay any disputed rent into court. However, if the lender is taking possession extra-judicially, the tenant may be faced with the prospect of having to commence an action to determine entitlement, with its attendant costs.

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[130] *Keech v. Hall* (1778), 1 Dougl. 21, 99 E.R. 17, and *Dudley and District Benefit Building Society v. Emerson*, [1949] Ch. 707.

[131] See Falconbridge, *supra*, note 62, at 327, citing *Doe d. Rogers v. Cadwallader* (1831), 2 B. & Ad. 473, 109 E.R. 1218; *Doe d. Whitaker v. Hales* (1881), 131 E.R. 124; *Smith v. Eggington* (1874), 31 L. & T. 150; and *Lever Finance, Ltd. v. Trustee of Property of Needleman*, [1956] Ch. 375, [1956] 2 All E.R. 378.

[132] See *supra*, this ch., sec. 2(a), regarding the duty and standard of care of a lender in possession.

[133] *Higgs v. Scott* (1849), 7 C.B. 63, 137 E.R. 26 (C.P.).

[134] *Finck v. Tranter*, [1905] 1 K.B. 427.

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

The law with respect to a lender's right to possession of property subject to a lease is unsatisfactory in several ways. Tenants can find themselves in an uncertain and often inequitable position where the borrower from whom they have leased the premises defaults under the security agreement. As we have discussed,[135] rent that is paid by a tenant to a party who is not legally entitled to such payment may not be recoverable, with the result that the tenant is required to pay double rent. A determination by the tenant of which party is legally entitled to receive such rents can be difficult, particularly where the claim involves a proportional claim for arrears,[136] and may necessitate an application by the tenant to the court.

A tenant may also be evicted by a lender who is not bound by the lease with the borrower. Although, in such a case, a lender may wish to leave the tenant in occupation and obtain rents until vacant possession is actually required for the purpose of a sale, the lender will be reluctant to do so since, upon demand for rent, a new tenancy will be presumed to arise on the same terms as the existing lease.[137] The lender is then required to fulfil the duties of a landlord and will be unable to take vacant possession of commercial premises until the termination of the lease; in the case of residential premises, the lender may be bound by the security of tenure provisions of the *Landlord and Tenant Act*.[138] As a result, lenders generally prefer to evict a tenant immediately under a non-binding lease, even where it might be to the advantage of both the lender and tenant not to do so.

This potential for immediate eviction is of particular concern with respect to residential tenants. Commercial tenants can be expected to inquire whether the borrower has a power to lease the secured property pursuant to the security agreement, thereby binding the lender and ensuring the tenants' claim to possession upon default by the borrower. In the absence of such a power, a commercial tenant is likely to negotiate with the lender a non-disruption clause, or a consent to lease, in order to ensure that possession can be retained. Residential tenants are less likely to make such inquiries regarding their right to possession *vis-à-vis* the lender, or to be in a position to negotiate for the lender's consent in the absence of a power to lease in the borrower. Moreover, Part IV of the *Landlord and Tenant Act*, which governs residential tenancies, does not protect a tenant from such immediate eviction by a lender under a non-binding lease, unless a new tenancy has been created. Indeed, there is some argument that the lender is not a landlord for the purpose of the *Landlord and Tenant Act*, even where the lease binds the lender who takes possession from the borrower.[139]

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[135] See *supra*, this ch., sec. 4(a)(iii).

[136] See *supra*, this ch., sec. 4(a)(ii).

[137] See *supra*, this ch., secs. 4(a)(i) and (iii).

[138] *Supra*, note 123, ss. 98 *et seq*.

[139] See *supra*, this ch., sec. 4(a)(iii).

(c) THE LAW IN THE UNITED STATES

Section 3-504(a) of the Uniform Land Transactions Act[140] provides that a lender who has taken possession of leased property may notify the tenant to pay rent to him or her rather than to the borrower. If the tenant is in doubt as to the lender's entitlement to rent, the tenant may request that the lender furnish reasonable proof of his or her right to the rent and need not make payment until such proof is given. The obligation of the tenant to the borrower is discharged by payment in good faith to the lender.

Section 3-207 of the Act governs a tenant's right to possession of leased land. Section 3-207(b) provides that where, subsequent to the mortgage, the borrower gives a lease in the ordinary course of business, the lease is effective against the lender for two years after the date of the lease. The Comment to the Act indicates that the policy underlying these provisions is that a borrower who is a landlord of rental property subject to a mortgage is in a position analogous to that of a merchant whose chattels or inventory are subject to a chattel mortgage or a conditional sales agreement. It is presumed that the lender is, or ought to be, aware of the nature of the borrower's business, which is the rental of the secured property. Therefore, where the lease is granted in the ordinary course of business, the tenant's interest ought not to be subject to that of the lender.

With respect to such leases made after a mortgage, the Comment explains that the lender is protected from possible collusion or "sweetheart deals" between the borrower and tenants by the provisions of section 3-207(b). In order to bind the lender, the lease must reserve a reasonable rent in the circumstances. In determining whether the rent is reasonable, the court must look at the circumstances existing at the time of leasing, rather than at the time the lender takes possession. The lease must contain a promise by the tenant to pay rent in periodic instalments, not more than three months in advance. The lease must provide for re-entry or termination of the lease within not more than two months after default by the tenant. And, finally, the lease must provide that the tenant is entitled to take possession within six months of the date of the lease or, in the case of a building under construction, not later than the completion of the leased premises. If the lease does not comply with these requirements, the tenant may be ejected by the lender upon the borrower's default under the mortgage.

In addition, section 3-207(d) of the Act provides that any option or right of renewal contained in a subsequent lease is invalid against the lender in possession under a non-binding tenancy agreement.

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[140] *Supra*, note 20.

(d) PROPOSALS FOR REFORM

(i) The Determination of Entitlement to Rent

We turn now to consider the determination of a lender's entitlement to rent, whether or not the lease is binding on the lender as a matter of law, and whether the leased premises are residential or commercial. In the Commission's view, a tenant should not be placed in the position of having to determine the validity of competing claims for rent in order to avoid liability for a mistaken payment. The Commission therefore recommends the following procedure. Where a borrower is in default, the lender should be entitled to serve the tenant with a notice, in prescribed form, demanding rent.[141] The notice should set out, in plain language, the reason for the notice, the rights and remedies of the lender, the borrower, and the tenant in respect of the notice, and such other information as may be prescribed.[142] Once the tenant receives the notice from the lender, the tenant should be required to make all payments of rent in the manner prescribed by the notice, until directed otherwise by the lender or the court.[143] A tenant who, in good faith, makes payments under these circumstances should be relieved from liability to the borrower.[144] If the tenant fails, without reasonable excuse, to make such payments, the tenant should be liable to the lender for the rent, including any rent paid to the borrower while the notice demanding rent was in force.[145]

In some cases, a tenant faced with conflicting claims to rent may be uncertain concerning which lender to pay. Accordingly, we recommend that where the tenant receives notices from more than one lender, the tenant should be required to comply with the notice from the lender having the prior interest in the secured property.[146] Where there is a dispute concerning such claims, the tenant should be entitled to apply to the court for directions. However, we believe that the tenant should not be liable for the costs of applying to the court to resolve a dispute in respect of which the tenant is, in a sense, a complete stranger. We therefore recommend that, where the tenant brings an application for directions, the tenant should be entitled to his or her solicitor and client costs. In order to avoid later disputes concerning such costs, they should be fixed by the court at the time of the tenant's application. The costs should be set off against the rent that the tenant is obliged to pay, unless the court orders otherwise.[147]

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[141] Draft Act, s. 6.31(1).

[142] *Ibid.*, s. 6.31(2).

[143] *Ibid.*, s. 6.31(4).

[144] *Ibid.*, s. 6.31(5).

[145] *Ibid.*, s. 6.31(6).

[146] *Ibid.*, s. 6.31(8).

[147] *Ibid.*, s. 6.31(10).

The Commission recognizes that, where the lender has no right to take possession and, therefore, has no entitlement to obtain rent, the borrower may be at a disadvantage if the rent that is properly payable to the borrower is diverted to the lender. In such a case, the borrower may even be deprived of the very funds that are needed to finance a challenge to the lender's claim in court. In order that the borrower is immediately alerted to the lender's claim for rent, the lender should be required to serve on the borrower a copy of the proposed notice to pay rent at the same time that the tenant is served.[148] The prescribed form of the notice to the borrower would state the reasons for the claim for the rent.[149]

Finally, we recommend that, where a dispute arises between the borrower and the lender as to the right to obtain rent, either party should be entitled to make an application to the court to resolve the issue.[150] The notice to the borrower should expressly advise him or her that any dispute regarding the lender's claim may be resolved by application to the court.[151]

(ii) Lender's Rights and Obligations Under a Binding Lease

As we discussed above,[152] at common law, where a lease binds a lender, the lender, upon taking possession from the borrower, is entitled to obtain rents and, at the same time, is required to assume the duties of a landlord. We see no reason to alter this general rule with regard to binding leases, except in two respects.

First, we recommend that the lender's entitlement to rent should include entitlement to payment of any arrears of rent.[153] This reform would do away with the necessity of determining such matters as the date upon which rents become payable or whether there should be an apportionment of such rents. We believe that the borrower will not be prejudiced by such a change to the existing rule, since both rent and arrears will be applied to reduce the debt owing to the lender and must be accounted for by the lender upon redemption or sale.

Secondly, as discussed earlier, a lender taking possession of residential property subject to a binding lease may not be subject to the obligations of a landlord under Part IV of the *Landlord and Tenant Act*.[154] Accordingly, we recommend that the definition of "landlord" in the *Landlord and Tenant Act* should be amended to remove any ambiguity by providing that that term shall include a lender in possession of property subject to a binding lease, whether that property is commercial or residential.

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[148] *Ibid.*, s. 6.31(3).

[149] *Ibid.*, s. 6.31(2).

[150] *Ibid.*, s. 6.31(9).

[151] *Ibid.*, s. 6.31(2)(b).

[152] See *supra*, this ch., sec. 4(a)(ii).

[153] Draft Act, s. 6.31(4).

[154] *Supra*, note 123.

(iii) Lender's Rights and Obligations Under a Non-Binding Lease

a. Introduction

As we have discussed,[155] where the secured property is subject to a non-binding lease, a lender generally will evict the tenant immediately, even though the *status quo* may be of benefit to both the lender and the tenant. This right to evict the tenant applies to both commercial and residential tenancies. The reason for the lender's action is clear. While the lender wants to obtain rent from a tenant in possession, a lender who demands rent will be presumed to have created a new tenancy, and will be required to fulfil the obligations of a landlord. Consequently, the lender will not be able to obtain vacant possession of commercial premises until the termination of the lease; with respect to residential tenancies, the lender may be bound by Part IV of the *Landlord and Tenant Act*,[156] including the security of tenure provisions.[157]

We believe that this state of affairs can create unnecessary hardship to tenants who suffer premature eviction. Moreover, this rule is of advantage to neither the borrower, who no longer receives rents from the tenant after eviction, nor the lender, who is often left with a property that produces no revenue until sale.

An alternative to eviction of the tenant or a presumed assumption by the lender of the existing lease would be to allow the lender to leave the tenant in possession and obtain rent for as long as is mutually agreeable to the tenant and lender, without requiring the lender to assume the obligations of a landlord.

We recognize that such a scheme might create some difficulties for the tenant. As the law now stands, the person to whom the tenant pays rent is required to satisfy the landlord's legal obligations. Generally, if the landlord fails to fulfil these duties, the tenant will withhold rent until the terms of the lease or the legislation are met. If a tenant is required to pay rent to the lender, who does not have the correlative obligations of a landlord, the tenant may have more difficulty enforcing rights against the borrower, who is the landlord.

b. Commercial Leases

We believe that a commercial tenant will often be content to accept this potential difficulty in enforcing rights against the borrower, in order to avoid premature eviction. Accordingly, we recommend that where a lender takes possession of property that is subject to a non-binding commercial lease, the lender should be entitled to pursue one of the following three alternative courses of action. The lender should continue to be entitled to evict the tenant.[158] Alternatively, the lender and tenant could enter into a new binding tenancy agreement. Or the lender should be entitled to demand and receive payment of rent from the tenant; such demand and receipt should not necessarily give rise to the inference that the lender has assumed the obligations of a landlord.[159]

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[155] See *supra*, this ch., sec. 4(a)(iii).

[156] *Supra*, note 123.

[157] *Ibid.*, ss. 98 *et seq.*

[158] Draft Act, s. 6.28(1).

It should continue to be a question of fact whether a new tenancy has been created by mutual consent, either express or implied. The course of conduct of the lender and the tenant, other than the mere demand for and payment of rent, may still give rise to the inference that the parties intended that a new and binding tenancy should be created.[160] Such conduct as a lender's encouragement of the tenant's improvement of the property, or service of a notice of distraint by the lender, may be sufficient to establish such an intention.

c. *Residential Leases*

The Commission believes that the existing law with respect to non-binding leases has the harshest impact on residential tenants. Commercial tenants are likely to determine whether the borrower has a power to lease under the security agreement and, in the absence of such a power, to negotiate with the lender regarding possessory rights in the event of the borrower's default. Residential tenants are much less likely to make such inquiries or to negotiate with the lender.

Moreover, residential tenants may not enjoy the protections of Part IV of the *Landlord and Tenant Act*[161] as against a lender who takes possession under a non-binding lease. The most important protection afforded to residential tenants under that Act is the security of tenure a tenant enjoys if the tenant fulfils his or her obligations to the landlord. A tenant who is not in breach of these obligations may not be evicted from residential premises, subject to certain narrow exceptions. Section 105 of the Act allows a landlord to take possession if the premises are required for occupancy by himself or herself, the landlord's spouse, or a child or parent of the landlord or his or her spouse. In such a case, the landlord must give the tenant not less than sixty days notice prior to taking possession.

Section 107 of the *Landlord and Tenant Act* provides another exception to the statutory security of tenure that residential tenants enjoy. A landlord is entitled to take possession from a residential tenant where the landlord requires the premises for the purpose of demolition, conversion to a non-residential use, renovation, or repair. In such a case, tenants are entitled to a minimum of 120 days notice in order to find suitable alternative accommodation. After receiving notice under either section 105 or 107, a tenant may terminate the tenancy agreement at an earlier date by giving the landlord at least ten days notice.

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[159] *Ibid.*, s. 6.31(11).

[160] Falconbridge, *supra*, note 62, at 327, citing *Doe d. Rogers v. Cadwallader*, *supra*, note 131, and *Lever Finance, Ltd. v. Trustee of Property of Needleman*, *supra*, note 131.

[161] *Supra*, note 123.

While a residential tenant enjoys these extensive protections *vis-à-vis* the borrower-landlord, the tenant under a non-binding lease is completely powerless to resist eviction in the event that the borrower defaults and the lender seeks actual possession. We believe that the existing rule is inconsistent with the policy behind Part IV of the *Landlord and Tenant Act*. The lender usually knows that the secured property contains rental premises, since the fact that the secured property is revenue-producing will almost certainly be part of the information the lender seeks and obtains upon the borrower's application for financing. We believe that the need of a residential tenant to have a reasonable opportunity to seek alternative accommodation, with a minimum of disruption, requires that the role of landlord should be imposed on the lender for a certain period of time.

We are, nevertheless, aware that the lender normally does not seek such a role but, rather, has been thrust into the position by the borrower's default. At the very least, the lender should be assured a reasonable rent while the tenant remains in possession. We further believe that the lender is entitled to be protected from any collusive dealings between the borrower and the tenant that may undermine this legitimate expectation.

Accordingly, we recommend that, where a lender takes possession of residential premises that are subject to a non-binding lease that satisfies the requirements to be proposed below (in order to prevent collusive arrangements between borrowers and their tenants), the terms of the lease should bind the lender for the period of its unexpired term, but not less than 120 days and not more than one year from the date the lender takes possession of the property.[162] This recommendation should apply to "residential premises" as defined in the *Landlord and Tenant Act*.[163]

Therefore, if the tenancy is a month to month tenancy, the tenant will have at least 120 days to relocate. This is the same amount of time as the tenant would have under the *Landlord and Tenant Act* if, for example, the landlord required the premises for renovation or repairs. If the tenant has a lease with a term of one year, he or she should be able to retain possession for the balance of the term of the lease, or for 120 days, whichever is greater. If the lease is for more than one year, the tenant should retain possession for at least 120 days, but not more than one year, depending on the length of the unexpired term.

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[162] Draft Act, s. 6.27(1).

[163] *Ibid*. The *Landlord and Tenant Act*, *supra*, note 123, s. 1(c), provides:

> 1.-(c) 'residential premises' means,
>
> (i) any premises used or intended for use for residential purposes, and
>
> (ii) land intended and used as a site for a mobile home used for residential purposes, whether or not the landlord also supplies the mobile home,
>
> but does not include,
>
> (iii) premises occupied for business purposes with living accommodation attached under a single lease unless the tenant occupying the living accommodation is a person other than the person occupying the premises for business purposes, in which case the living accommodation shall be deemed residential premises, or
>
> (iv) such other class or classes of accommodation as may be designated by the regulations; ...

In order that a lender should not be bound by a collusive arrangement or "sweetheart deal" between the borrower and a tenant, the Commission recommends that the preceding proposal should apply only to a non-binding lease of residential premises that meets the minimum requirements recommended below.

First, the rent provided by the lease between the borrower and the tenant should be commercially reasonable for the premises in question. The time for determining the reasonableness of the rent should be the time at which the lease was entered into, not the date at which the lender takes possession. Secondly, in order to prevent the borrower, prior to default, from obtaining payment in advance of rents that would otherwise be paid to the lender upon taking possession, we recommend that the lease must provide for payment of rent no more than three months in advance. Thirdly, the tenant must be required to take possession of the premises not more than six months after the date of the lease, or, where the premises are under construction, upon completion of the construction.[164]

A lender should be bound only by an otherwise non-binding lease that meets these requirements. Any dispute with respect to whether a lease meets these requirements should be resolved by the court on the application of the lender or the tenant.[165]

Where a lender takes possession of residential premises under the circumstances described above, the lender should be required immediately to give written notice that he or she has taken possession and has become the landlord, and setting out the date on which the lender is entitled to obtain vacant possession of the secured property.[166]

During the time that the lender is in possession of the residential premises, the lender should have all the rights and be subject to all the obligations of a landlord.[167] In order to resolve any uncertainty, Part IV of the *Landlord and Tenant Act* should be made to apply to such a tenancy, except that, notwithstanding the provisions of Part IV respecting the termination of a tenancy, the lender should be entitled to a writ of possession upon expiration of the period proposed above.[168]

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[164] Draft Act, s. 6.27(1).

[165] *Ibid.*, s. 6.27(4).

[166] *Ibid.*, s. 6.27(2).

[167] *Ibid.*, s. 6.27(3).

[168] *Ibid.*, s. 6.27(5).

Where a non-binding lease of residential premises does not meet the minimum requirements proposed above, the rights of the lender *vis-à-vis* the tenant and the borrower should be the same as those recommended in the preceding section for a lender in possession of property subject to a non-binding commercial lease.[169]

d. Eviction

We recommend that, with respect to a commercial lease and a residential lease that does not meet the minimum requirements proposed above, a lender who intends to evict the tenant should be under a duty to send a notice to quit, in prescribed form, to the tenant.[170] The notice should specify the date on which the lender requires vacant possession, not earlier than ten days from receipt of the notice.[171] If the tenant refuses to give vacant possession, the lender should be entitled to apply for a writ of possession.[172] For the reasons given earlier in this chapter with respect to taking possession from the borrower,[173] we further recommend that the application for a writ of possession should not be capable of being stayed or adjourned on the ground of hardship.[174]

5. THE LENDER'S POWER OF DISTRESS

(a) PRESENT LAW

Distress is a self-help remedy that involves the taking or seizure of chattels from the owner's possession, without legal process, as a pledge for redressing an injury, or for ensuring the performance of a duty or the satisfaction of a demand.[175] It is a right that can arise at common law, by statute, or by agreement between the parties.

Distress is most commonly exercised by a landlord with respect to recovery of arrears of rent from a tenant. The right of a landlord to distrain the chattels of a tenant is governed by the *Landlord and Tenant Act*,[176] which requires, among other things, that distress by a landlord shall be reasonable.

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[169] *Ibid.*, s. 6.28.

[170] *Ibid.*, s. 6.28(1).

[171] *Ibid.*, s. 6.28(2).

[172] *Ibid.*, s. 6.29.

[173] See *supra*, this ch., sec. 1(d)(vi).

[174] Draft Act, s. 7.4.

[175] Burke (ed.), *Jowitt's Dictionary of English Law* (2d ed., 1977), at 630.

[176] *Supra*, note 123, ss. 40-55.

In our 1968 *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies*, the Commission recommended that the right of a landlord to distrain with respect to residential tenancies should be abolished.[177] It was our view that the advantages of distress to residential landlords were far outweighed by its disadvantages to tenants and the public. We recognized that distress was effective mainly by virtue of its devastating consequences, in terms of disruption and cost to the tenant. In our view, it was clear that, where distress was carried through to sale, the recovery to the landlord hardly justified the expenditure, and the detriment to the tenant was substantial.[178] Our recommendation was implemented by what is now section 86 of the *Landlord and Tenant Act*, which abolishes the remedy of distress with respect to residential tenancies.

The right to exercise the remedy of distress is not, however, limited to a landlord. A secured lender may also enjoy the right to distrain the chattels of a borrower for arrears in mortgage payments. However, the remedy of distress is not a necessary incident of a mortgage as it is of a tenancy agreement. Rather, the right to distrain is created either as a term of the mortgage, or as an incident of an attornment clause that establishes the relationship of landlord and tenant between a lender and a borrower.[179] Prior to its amendment, the *Short Forms of Mortgages Act*[180] contained a standard clause giving the lender a right to distrain for arrears of interest.[181] However, we are advised that this remedy is not commonly exercised by lenders.

The exercise of a lender's remedy of distress is governed by sections 13, 14 and 15 of the *Mortgages Act*.[182] Sections 13 and 14 create certain limitations on the lender's right to distrain with respect to other creditors of the borrower. Section 15 provides that "[g]oods and chattels distrained by a mortgagee shall not be sold except after such public notice as is required to be given by a landlord who sells goods and chattels distrained for rent".

(b) DEFICIENCIES IN THE LAW AND THE CASE FOR REFORM

As we observed in our *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies*, the remedy of distress is mainly effective by virtue of its extreme disruption and cost, particularly to residential tenants.

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[177] Ontario Law Reform Commission, *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies* (1968), at 20.

[178] *Ibid.*, at 17-18.

[179] Falconbridge, *supra*, note 62, at 761.

[180] *Supra*, note 3.

[181] *Ibid.*, Schedule B, para. 14. As we have noted (see *supra*, note 3), the *Short Forms of Mortgages Act* was amended by s. 24 of the *Land Registration Reform Act, 1984*, *supra*, note 2. This section repealed s. 6 of the principal Act and substituted a new provision that, in effect, renders the *Short Forms of Mortgages Act* inapplicable to future mortgages in Ontario. The right to distrain can, however, be incorporated by reference to para. 14 as a matter of contract.

[182] R.S.O. 1980, c. 296.

Even where the distress is actually carried through to sale, the lender's recovery from the sale of chattels of a residential tenant hardly warrants the costs of sale, while the harm to the tenant can be great.

We believe that the argument that led to the abolition of distress by landlords with respect to residential tenants also militates in favour of the abolition of the lender's remedy of distress with respect to protected borrowers. In our view, it is anomalous that a lender should continue to enjoy the right to distrain for arrears of residential loan payments, when this remedy has been abolished with respect to landlords of residential premises. The concerns regarding the cost and disruption to a tenant who occupies residential premises arise equally with respect to a borrower who occupies residential secured property. This anomaly is particularly acute in light of the fact that, unlike a landlord, a lender who has a security agreement is a secured creditor enjoying other, and indeed more effective, remedies for recovery of the borrower's debt or obligation.

(c) PROPOSALS FOR REFORM

Accordingly, we recommend that a lender's right to distrain with respect to property of a protected borrower should be abolished.[183] We further recommend that provisions analogous to sections 13, 14 and 15 of the *Mortgages Act* should continue to govern a lender's right to distrain where the borrower is not a protected borrower.[184]

RECOMMENDATIONS

The Commission makes the following recommendations:

1. (1) A borrower who is not a protected borrower should be entitled to retain possession of the secured property until there has been a default under the security agreement. Upon default, the lender should be entitled to take possession of the secured property.

   (2) In transactions that do not involve protected borrowers, the parties should be entitled to contract out of the general rule proposed in paragraph (1) and to establish, either before or after default, their own rules governing rights to possession of the secured property.

2. (1) Where the borrower is a protected borrower, the lender should not be entitled to take possession of the secured property until the proposed minimum four month delay period has expired, subject to the exceptions proposed in Recommendations 3(2), 4, and 5.

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[183] Draft Act, s. 6.25(6).

[184] *Ibid.*, s. 6.25(1)-(5).

(2) The lender should be required to obtain a writ of possession and should be entitled to the writ at any time after default, but the writ should not be effective until the expiry of the four month delay period.

(3) The protected borrower should be advised in the notice of default of the right to remain in possession during the delay period.

3. (1) Any term of the security agreement, or any collateral agreement entered into, that purports to waive or limit a protected borrower's right to possession until expiration of the proposed delay period should be void and unenforceable.

(2) However, a protected borrower should be entitled to consent to possession by the lender, provided that such consent is in writing and has not been sought or given until after service of the notice of sale on the borrower.

4. (1) A lender should be entitled at any time to apply to the court for leave to issue a writ of possession without notice to the borrower.

(2) Among the circumstances that should be considered by the court in such an application should be the abandonment or apparent abandonment of the secured property by the borrower and the commission, or the failure to prevent the occurrence, of waste of the secured property.

(3) The court should be empowered, having regard to the circumstances, to grant leave to issue the writ of possession without notice or with such notice to such persons, in such manner, and within such time as the court considers proper.

5. (1) Prior to the expiry of the proposed delay period, the lender should be entitled to take possession of property that has been or appears to have been abandoned, without obtaining a writ of possession.

(2) The lender should be entitled to presume that the property has been abandoned where all reasonably available evidence, including the condition of the property, would lead a reasonable person to believe that the borrower has vacated the property and does not intend to return.

(3) The lender should be required to make reasonable inquiries in order to obtain such evidence and, more particularly, to determine whether the borrower's absence is of a temporary or permanent nature.

6. A notice of the lender's intention to take possession of the property should be served on the borrower. The lender should also be required to post a notice on the property, stating that the lender intends to take

possession, in order that a returning borrower may be made aware of any proceedings that have taken place in his or her absence.

7. If the borrower did not intend to abandon the property, he or she should be entitled to retake possession immediately.

8. A lender who has taken possession without reasonable belief that the property has been abandoned, or without having complied with the procedural safeguards proposed above, should be liable for any actual damage suffered by the borrower. Where, however, the lender has acted reasonably in assuming the property was abandoned, the lender should not be liable to the borrower, notwithstanding that the lender was in error in taking possession.

9. Where the lender takes possession of the secured property and finds chattels on that property, the lender should be required to conduct such searches as may be appropriate in the circumstances against the name of the borrower, of motor vehicles for which permits have been issued under the *Highway Traffic Act*, and of the individual debtor index, business debtor index, or motor vehicle index established under the *Personal Property Security Act*.

10. (1) Where it appears to the lender, from a search or otherwise, that a person has or may have an interest in any of the abandoned chattels, the lender should be required to give notice in writing to such person that the lender has taken possession of the chattels.

    (2) Such a person should be required to make a claim to the chattels within fifteen business days after notice in writing has been received.

11. Where a person makes a claim to an interest in the abandoned chattels, either as a result of, or independently of, the lender's notice, and the lender believes on reasonable grounds that that person's claim is valid, the lender should be required to permit such person to take possession of the chattels. Where the lender does so, the lender should incur no liability to the borrower, the true owner of the chattels, or any person having interest in the chattels.

12. The lender or a claimant should be entitled to apply to the court in order to determine the validity of any claim made to an interest in chattels abandoned on the secured property.

13. (1) Where the lender believes, on reasonable grounds, that no person other than the borrower has an interest in any of the abandoned chattels, or where a person who has received the lender's notice does not respond to the notice within fifteen business days after receipt, the lender should be entitled to sell or otherwise dispose of

the chattels by any commercially reasonable method, without liability to the borrower, the true owner of the chattels, or any other person having an interest in the chattels.

(2) Where, in accordance with paragraph (1), the lender disposes of abandoned chattels that are subject to a personal property security interest or owned by a person other than the borrower, to a person who acquires them in good faith, the rights of the secured party or true owner in respect of the property or any proceeds thereof should be extinguished. The lender should be able to sell the chattels free of such rights.

14. Where a third party's rights in the chattels have been extinguished, the lender should be required to account to the third party up to the amount of the proceeds of sale, or the value of the chattels if the lender has kept them, after deducting the reasonable expenses incurred in selling the chattels or otherwise lawfully dealing with them.

15. Where the lender disposes of chattels by sale, the proceeds of disposition should be applied first to pay the lender's reasonable expenses of disposing of the chattels, including the costs of processing or preparing the chattels for sale. The balance of the sale proceeds should be distributed as part of the proceeds of the sale of the secured property.

16. There should be no jurisdiction in the court to postpone the lender's right of possession, or to adjourn any proceedings instituted in respect of that right, beyond the proposed four month delay period.

17. (1) The standard of care for a lender or a lender's agent in the custody and preservation of secured property in the lender's possession should be that of commercially reasonable care, having regard to the nature of the secured property. Accordingly, the lender or the lender's agent would be required to do whatever was usual or customary in order to maintain the value, usefulness, and condition of the property, having regard to the interests of the borrower, subsequent encumbrancers, and others who may be affected by a breach of the proposed standard, and to the nature and condition of the property.

(2) The proposed statutory formulation of the standard of care for a lender or a lender's agent should not specify particular duties that would satisfy the standard.

(3) The costs of such custody and preservation should be borne by the borrower and, therefore, added to the debt.

(4) There should be no change to the existing rule that a lender is liable for the acts of the agent, pursuant to the common law principles of agency.

18. The borrower or any person having an interest in the property should continue to be entitled to apply to the court to enjoin a lender or a lender's agent whose actual or expected standard of conduct in the care of the property fails, or will fail, to meet the proposed standard.

19. If the lender or the lender's agent fails to comply with the proposed standard of care, the lender and the lender's agent should be jointly and severally liable for any loss or damage caused to any person, including the borrower, subsequent encumbrancers, and guarantors, who, in the reasonable contemplation of the lender or the lender's agent, might suffer such loss or damage.

20. If a borrower is held liable for wrongdoing for which the lender in possession is responsible, the borrower should be entitled to indemnification by the lender.

21. (1) The proposed standard of commercially reasonable care to be exercised by a lender in possession should not be capable of being waived or limited by the borrower, whether or not a protected borrower.

    (2) However, the parties to a transaction that does not involve a protected borrower should be entitled to define, in advance, the conduct required of a lender in possession in order to satisfy the standard of commercial reasonableness.

    (3) Upon the application of any person who is affected by the issue whether the standard of commercial reasonableness has been satisfied, the court should be empowered to determine the issue, notwithstanding that such conduct conforms to the terms agreed upon by the borrower and the lender.

22. (1) The lender should be entitled to recover moneys spent in the repair of the property, provided that the expenditure is commercially reasonable in the circumstances.

    (2) The borrower, the lender, or any interested person should be entitled to apply to the court for a determination whether a proposed expenditure or an expenditure already incurred is or was commercially reasonable and, therefore, recoverable by the lender.

23. (1) The lender should be entitled to claim, as part of the expenses of possession, reasonable compensation for his or her own care and trouble in fulfilling necessary duties in the management of the secured property.

    (2) The parties should be free to agree in advance regarding what constitutes reasonable compensation for the lender's services. However, the lender should be entitled to no greater compensation than is reasonable in the circumstances.

(3) The agreed amount should be subject to challenge in court by any interested person.

24. (1) There should be no change to the existing law that allows a lender to recover the costs of employing an agent where it was commercially reasonable to do so.

(2) However, the reasonableness of the costs of an agent should be capable of being challenged in court by any interested person.

25. (1) Where a borrower is in default, the lender should be entitled to serve a tenant of the borrower with a notice, in prescribed form, demanding rent.

(2) The notice should set out, in plain language, the reason for the notice, the rights and remedies of the lender, the borrower, and the tenant in respect of the notice, and such other information as may be prescribed.

26. (1) Once the tenant receives the notice from the lender, the tenant should be required to make all payments of rent in the manner prescribed by the notice, until directed otherwise by the lender or the court.

(2) A tenant who, in good faith, makes the payments under these circumstances should be relieved from liability to the borrower.

(3) Where the tenant fails, without reasonable excuse, to make such payments, the tenant should be liable to the lender for the rent, including any rent paid to the borrower while the notice demanding rent was in force.

27. (1) Where the tenant receives notice from more than one lender, the tenant should be required to comply with the notice from the lender having the prior interest in the secured property.

(2) Where the tenant, faced with conflicting claims to rent, is uncertain as to a lender's right to the rent, the tenant should be entitled to apply to the court for directions.

(3) Where the tenant brings such application, the tenant should be entitled to his or her solicitor and client costs, to be fixed by the court at the time of the application.

(4) The costs should be set off against the rent that the tenant is obliged to pay, unless the court orders otherwise.

28. The lender should be required to serve on the borrower a copy of the proposed notice to the tenant to pay rent at the same time that the tenant is served.

29. (1) Where a dispute arises between the borrower and the lender as to the right to obtain rent, either party should be entitled to make an application to the court to resolve the issue.

(2) The notice to the borrower should expressly advise him or her that any dispute regarding the lender's claim may be resolved by application to the court.

30. Where a lease binds the lender:

(a) the lender's entitlement to rent should include entitlement to payment of any arrears of rent; and

(b) the definition of "landlord" in the *Landlord and Tenant Act* should be amended to provide that that term shall include a lender in possession of property subject to a binding lease, whether that property is commercial or residential premises.

31. (1) Where a lender takes possession of property that is subject to a non-binding commercial lease, the lender should be entitled either to evict the tenant, to enter into a new binding tenancy agreement, or to demand and receive payment of rent from the tenant.

(2) The lender's demand for, and receipt of, rent should not necessarily give rise to the inference that the lender has assumed the obligations of a landlord.

32. (1) Where a lender takes possession of residential premises, as defined in the *Landlord and Tenant Act*, that are subject to a non-binding lease that satisfies the requirements proposed in paragraph (2), the terms of the lease should bind the lender for the period of its unexpired term, but not less than 120 days and not more than one year from the date the lender takes possession of the property.

(2) The preceding proposal should apply only to a non-binding lease of residential premises that meets the following minimum requirements:

(a) the rent provided by the lease between the borrower and the tenant should be commercially reasonable for the premises in question; the time for determining the reasonableness of the rent should be the time at which the lease was entered into, not the date at which the lender takes possession;

(b) the lease must provide for payment of rent no more than three months in advance; and

(c) the tenant must be required to take possession of the premises not more than six months after the date of the lease, or, where the premises are under construction, upon completion of the construction.

(3) Any dispute with respect to whether a lease meets the requirements described in paragraph (2) should be resolved by the court on the application of the lender or the tenant.

33. Where a lender takes possession of residential premises under the circumstances described in the preceding recommendation, the lender:

(a) should be required immediately to give written notice that he or she has taken possession and has become the landlord, and setting out the date on which the lender is entitled to obtain vacant possession of the secured property; and

(b) should have all the rights and be subject to all the obligations of a landlord, and in order to resolve any uncertainty, Part IV of the *Landlord and Tenant Act* should be made to apply to such a tenancy, except that, notwithstanding the provisions of Part IV respecting the termination of a tenancy, the lender should be entitled to a writ of possession upon expiration of the period proposed in Recommendation 32(1).

34. Where a non-binding lease of residential premises does not meet the minimum requirements proposed in Recommendation 32(2), the rights of the lender *vis-à-vis* the tenant and the borrower should be the same as those recommended for a lender in possession of property subject to a non-binding commercial lease (see Recommendation 31).

35. (1) With respect to a commercial lease and a residential lease that does not meet the minimum requirements proposed in Recommendation 32(2), a lender who intends to evict the tenant should be under a duty to send to the tenant a notice to quit, in prescribed form, specifying the date on which the lender requires vacant possession, not earlier than ten days from the receipt of the notice.

(2) If the tenant refuses to give vacant possession, the lender should be entitled to apply for a writ of possession.

(3) The application for a writ of possession should not be capable of being stayed or adjourned on the ground of hardship.

36. (1) A lender's right to distrain with respect to property of a protected borrower should be abolished.

(2) Provisions analogous to sections 13, 14, and 15 of the *Mortgages Act* should continue to govern a lender's right to distrain where the borrower is not a protected borrower.

CHAPTER 11

MISCELLANEOUS MATTERS

1. THE RESOLUTION OF DISPUTES

(a) THE NEED FOR A SUMMARY PROCEDURE

Throughout the deliberations of the Commission's Research Team and the Advisory Committee, considerable emphasis was placed on the need for an expeditious, efficient, and inexpensive procedure to resolve disputes that might arise as a result of the borrower-lender relationship. Animating this concern was a belief that one of the major deficiencies of the law in this area was the time, energy, and money wasted in mortgage proceedings, particularly when lenders sought to invoke the contractual and statutory remedies available to them.

The view that existing dispute resolution procedures were unsatisfactory arose in the early stages of the Commission's study, when those procedures were governed largely by the Supreme Court of Ontario Rules of Practice,[1] subsequently superseded by the new Rules of Civil Procedure.[2]

This sense of the inadequacy of the existing procedures was exacerbated when it became clear that, as a result of the Commission's recommendations, there would likely be a wider variety of circumstances in which resort to an expeditious dispute resolution procedure would be necessary. For example, the Commission has recommended that a court should be empowered, on application, to determine the following matters: whether a provision in a commercial security agreement that defines conduct of a lender in possession satisfies the proposed standard of commercially reasonable care;[3] whether a lender's proposed improvements to the secured property are reasonable and do not seriously impair the borrower's right to redeem;[4] whether a lender's claim for remuneration in respect of the care and time expended by a lender in possession, and in respect of the use of an agent, is reasonable;[5] whether a lender in possession of leased property has a right to require tenants to pay rent to the lender;[6] and whether a lender is bound by leases of secured residential premises.[7]

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[1] Rules of Practice, R.R.O. 1980, Reg. 540.

[2] Rules of Civil Procedure, O. Reg. 560/84.

[3] See *supra*, ch. 10, sec. 2(d)(vi). See, also, the draft *Land Security Act* proposed by the Commission, *infra*, Appendix 1 (hereinafter referred to as "draft Act"), s. 6.30(4), (5), and (7).

[4] See *supra*, ch. 10, sec. 3(c)(i), and draft Act, s. 6.30(6) and (7).

Given the perceived inadequacies of existing law and practice, research was conducted into the feasibility and desirability of an entirely new summary procedure designed exclusively for use in the context of land security transactions, or at least in respect of certain aspects of such transactions. It was envisaged that the disputes that could arise would fall essentially into four categories: (1) non-compliance by a lender with statutory obligations; (2) mathematical calculations; (3) substantive issues; and (4) the possession remedy.

While the Research Team initially endorsed the creation of a new summary procedure, this position was subsequently modified after consultation with the Advisory Committee, whose members generally rejected the need for a new procedure, at least at this juncture. The Commission has come to share the views of the Advisory Committee.

Our reasons for rejecting the concept of an entirely new, separate, and comprehensive summary procedure designed exclusively for land security arrangements are two-fold. First, the proposals offered in this Report would create self-help remedies in many areas, and these remedies would not require, for their initial exercise, the intervention of the court. Secondly, as we have said, the Rules of Practice, on which the original research and early criticisms had been based, have been superseded by the Rules of Civil Procedure;[8] these new rules, modified in one important respect, are expected to ameliorate problems in several other areas.

(i) The Existence of Self-Help Remedies

It should be clear that the proposed self-help remedies occupy a pivotal position under the Commission's recommendations. For example, we have recommended that the primary remedy for the realization of a lender's security should be a new extra-judicial power of sale,[9] with foreclosure confined to a very limited number of cases.[10] The Commission has provided, in considerable detail, for the exercise of this reformed power of sale, dealing with, among other things, notices of default and of sale, delay periods prior to sale, stays, the standard of care in the conduct of a sale, the lender's use of an agent, and the effect of a sale. In addition, the Commission has attempted to delineate in some detail the right of a lender to possession and the lender's rights and obligations while in possession.[11]

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[5] See *supra*, ch. 10, secs. 3(c)(ii) and (iii), and draft Act, ss. 6.13(1)(a) and 6.30(6)(b) and (7).

[6] See *supra*, ch. 10, sec. 4(d), and draft Act, s. 6.31, esp. s.s. (9).

[7] See *supra*, ch. 10, sec. 4(d)(iii)c., and draft Act, s. 6.27(1) and (4).

[8] *Supra*, note 2.

[9] See *supra*, ch. 8, secs. 6(a) and (b), and draft Act, s. 6.4.

[10] See *supra*, ch. 8, sec. 6(c), and draft Act, ss. 6.15-6.17.

These proposals are designed to reduce the need for judicial adjudication. For example, so long as the lender follows the proposed legislative guidelines respecting reasonable inquiries concerning the borrower's alleged abandonment of the property and respecting the notice to be given to the borrower, the lender would be entitled, extra-judicially, to take possession of property abandoned by the borrower.

It is anticipated that the existence of these and other self-help remedies would lessen the necessity for resort to the court. However, disputes will, of course, continue to arise. Moreover, several Commission recommendations expressly envisage resort to the court where a particular claim is challenged. Accordingly, it is necessary to examine briefly the summary procedure provisions of the new Rules of Civil Procedure.

(ii) The Rules of Civil Procedure

While, at this stage in the life of the new Rules of Civil Procedure, it cannot be said with complete assurance that they provide adequate means for the resolution of disputes that can arise between borrowers and lenders, the Rules do provide for the summary resolution of such disputes.

Insofar as mortgages are concerned, the major difference between the old Rules of Practice and the new Rules of Civil Procedure is the abolition of the specially endorsed writ.[12] The new Rules still make it possible for a lender to obtain a speedy judgment in an action on the covenant and in an action for foreclosure or possession. However, the procedure under the Rules of Civil Procedure is, in some respects, radically different from the procedure followed in an action commenced by way of a specially endorsed writ.

Where the defendant fails to defend the suit, the existing procedure for obtaining judgment is virtually identical to that under the old Rules of Practice. Rule 19.01(1) of the new Rules permits the plaintiff to note the defendant in default where he or she fails to deliver a statement of defence in the prescribed time. The consequences of being noted in default are set out in rule 19.02. This rule prohibits the defendant from denying the truth of the allegations in the statement of claim and from taking any step in the action except with leave of the court or the consent of the plaintiff. Where the defendant has been noted in default, rule 19.04(1) allows the plaintiff to sign judgment against the defendant in the case of four types of action, three of which are relevant to the mortgage context. Rule 19.04(1) provides as follows:

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[11] See *supra*, ch. 10, secs. 1(d), 2(d), 3(c), 4(d), and 5(c), and draft Act, ss. 6.21-6.24 and 6.26-6.31.

[12] See Rules of Practice, *supra*, note 1, r. 33.

> 19.04(1) Where a defendant has been noted in default, the plaintiff may require the registrar to sign judgment against the defendant in respect of a claim for,
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> (a) a debt or liquidated demand in money, including interest if claimed in the statement of claim (Form 19A);
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> (b) the recovery of possession of land (Form 19B);
>
> (c) the recovery of possession of personal property (Form 19C); or
>
> (d) the foreclosure, sale or redemption of a mortgage (Forms 64B to 64D, 64G to 64K and 64M).

The major difference between the former Rules and the new Rules is in respect of actions that are defended. Under the old Rules of Practice, the defendant was required to file an affidavit of merits, upon which he or she could be cross-examined by the plaintiff before the plaintiff moved for judgment, and the plaintiff was not required to file any affidavit material of his or her own. By way of contrast, Rule 20 of the new Rules of Civil Procedure permits both parties to move for summary judgment and obligates both parties to support their position with affidavit material. Thus, on a motion for summary judgment, both the plaintiff and the defendant are exposed to cross-examination on affidavit. Other procedural changes make a motion for summary judgment more costly than a motion for judgment under the Rules of Practice.[13] In addition, new Rule 20 contains a provision empowering the courts to impose cost sanctions where the summary judgment procedure is incorrectly invoked.[14] Thus, parties may be more reluctant to move for judgment under the new Rules than under the old Rules, at least until counsel have gained some experience with the manner in which the courts will use the powers available to them.

Under the Rules of Practice, courts were extremely reluctant to grant judgment. The threshold test that a defendant had to meet in order to be entitled to defend the action fully was very low: the defendant had to establish only that there was a triable issue, and the courts would refuse to find a triable issue only where there was no reasonable doubt as to the defence raised by the defendant. Rule 20.04(2) of the Rules of Civil Procedure authorizes a court to grant summary judgment where there is "no genuine issue for trial". It remains to be seen whether the courts will interpret the "genuine issue" test as imposing a higher standard than the former "triable issue" test.[15]

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[13] For example, with respect to the preparation and filing of a factum, see Rules of Civil Procedure, *supra*, note 2, r. 20.03.

[14] Rule 20.06(1) and (2) provides as follows:

> 20.06(1) Where, on a motion for summary judgment, the moving party obtains no relief, the court shall fix the opposite party's costs of the motion on a solicitor and client basis and order the moving party to pay them forthwith unless the court is satisfied that the making of the motion, although unsuccessful, was nevertheless reasonable.
>
> (2) Where it appears to the court that a party to a motion for summary judgment has acted in bad faith or primarily for the purpose of delay, the court may fix the costs of the motion on a solicitor and client basis and order the party to pay them forthwith.

The only other new rule to which reference should be made here is rule 14.05, which is concerned with applications by way of a notice of application, formerly known as an originating notice of motion. This procedure, which is used extensively in the Commission's proposed new *Land Security Act*,[16] is important for a host of issues that can arise between lenders and borrowers and that do not require a full action. If anything, the procedural changes reflected in this rule, as modified in the manner recommended below, should assist the parties in achieving a summary resolution of minor disputes.

Two new provisions relating to the circumstances in which parties may avail themselves of this procedure are particularly noteworthy. Rule 14.05(3)(d) and (h) provides as follows:

> 14.05(3) A proceeding may be brought in the Supreme Court by application where these rules authorize the commencement of a proceeding by application or where the relief claimed is,
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> . . . .
>
> (d) the determination of rights that depend on the interpretation of a deed, will, contract or other instrument, or on the interpretation of a statute, order in council, regulation or municipal by-law or resolution;
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> . . . .
>
> (h) in respect of any matter where it is unlikely that there will be any material facts in dispute.

Should the Commission's proposed *Land Security Act* be enacted, it is likely that there will be a certain degree of uncertainty about the meaning or interpretation of parts of the Act. Rule 14.05(3)(d) permits use of the notice of application procedure in the event that the parties require an interpretation of the Act. Rule 14.05(3)(h) broadens considerably the circumstances in which resort might be made to the notice of application procedure and will probably be relied upon frequently in the context of security agreements, where the material facts are not in dispute but where the legal consequences of the factual setting are hotly contested.

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[15] In his article "Summary Judgment: A Comparative and Critical Analysis" (1981), 19 Osgoode Hall L.J. 552, Professor Bogart reviewed the experience under the British Columbia summary judgment rule, upon which the Ontario rule is to some extent modelled. He concluded that the British Columbia courts were no more willing to grant summary judgment under that rule than under the former British Columbia rules of practice. If the Ontario courts continue to be very reluctant to deny defendants their day in court, new R. 20 will have taken certain advantages away from plaintiffs without in any way making the possibility of summary judgment any easier. Such an eventuality might have serious consequences for the lending industry and might require some alternative dispute resolution procedures.

[16] *Supra*, note 3.

(b) CONCLUSION

As a general principle, we expect that the application procedure provided by the new Rules of Civil Procedure will allow for the expeditious resolution of all those matters that we have recommended be resolved by application to the court, pursuant to the proposed *Land Security Act*. However, we believe that the goal of a summary disposition of these matters will not be fully realized if such applications can be heard only by a judge or local judge of the Supreme Court of Ontario.[17] Accordingly, we have examined the possibility of directing applications to a master of the Supreme Court.

Having regard, however, to the nature of the questions to be determined in an application proceeding, the Commission is concerned that leaving the adjudication to a master would violate section 96 of the *Constitution Act, 1867*.[18] Section 96 confers upon the Governor General in Council the authority to appoint judges of the superior, county, and district courts. As a corollary, a province cannot transfer the jurisdiction of those courts to judges or officers whom it appoints.[19]

In *Attorney-General for Ontario and Display Service Co. Ltd. v. Victoria Medical Building Ltd.*,[20] the Supreme Court of Canada held unconstitutional a provision of the Ontario *Mechanics' Lien Act*[21] that gave the master jurisdiction to try mechanics' lien actions and to render final judgment. The Court held that the master could not be given the power of final adjudication as a substitute for a section 96 judge. Under the statutory provision under consideration, the jurisdiction of the master was not analogous to the confined and controlled jurisdiction ordinarily exercised on a reference, where the master's findings are not embodied in a judgment.

In a later case, *Zacks v. Zacks*,[22] the Supreme Court again considered the relationship between a provincially appointed master and a section 96 judge. The Court stated that there would be no violation of section 96 provided that the jurisdiction conferred upon a provincially appointed officer is limited to the power to inquire and report, as distinguished from the power to adjudicate. The supervision exercised by the referring judge over the findings of the referee must be genuine. Section 96 would appear to be violated where there is only a *pro forma* confirmation by the referring judge.[23]

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[17] Rule 14.05 provides for the commencement of proceedings by application. However, the Rule provides for an application to either the Supreme Court or District Court. Rule 38.02 provides that a local judge of the Supreme Court has jurisdiction to hear applications, subject to certain exceptions.

[18] 30 & 31 Vict., c. 3 (U.K.).

[19] See, for example, *Re Residential Tenancies Act, 1979*, [1981] 1 S.C.R. 714, aff'g (1980), 26 O.R. (2d) 609, 105 D.L.R. (3d) 193 (C.A.).

[20] [1960] S.C.R. 32, 21 D.L.R. (2d) 97. With respect to the jurisdiction of the master, see *Re S.B.I. Management Ltd. and 109014 Holdings Ltd.*, [1981] 5 W.W.R. 714, 128 D.L.R. (3d) 89 (Alta. C.A.).

[21] R.S.O. 1950, c. 227, s. 31(1).

[22] [1973] S.C.R. 891, 35 D.L.R. (3d) 420.

The Commission has come to the conclusion, and accordingly recommends, that applications pursuant to the proposed *Land Security Act* should be heard not only by a judge or local judge of the Supreme Court of Ontario, as is now the case under the Rules of Civil Procedure, but also by a master of the Supreme Court. The legislative mechanism empowering a master to hear such applications should be designed to meet any constitutional objections raised by section 96 of the *Constitution Act, 1867*.[24]

As stated earlier, we recognize that it is impossible at this time to predict what effect the new Rules, and our proposed Act, will have. With more experience under the new regime and with the enactment of the *Land Security Act*, it might become clear that the Rules of Civil Procedure and the Act are unequal to the task of providing an expeditious, effective, and inexpensive means of resolving disputes. However, we are of the opinion that it is premature at this stage to draw such a conclusion. Accordingly, we are of the view that careful vigilance in respect of the procedural aspects of the new regime is essential. To this end, in this chapter the Commission will recommend the establishment of a permanent committee, the function of which would be to monitor land security transactions and the operation of the new legislation. This committee, as well as other review bodies, such as the Rules Committee of the Supreme and District Courts,[25] should be able to detect, at an early stage, any deficiencies in the procedural rules relating to the summary resolution of disputes arising between borrowers and lenders.

2. SERVICE OF DOCUMENTS

We now turn to our proposals respecting the service of documents. In large measure, the method of service will incorporate several provisions of the Rules of Civil Procedure and the *Mortgages Act*.[26] The details of these incorporated provisions need not be described here.[27]

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[23] See *Maitre v. Chisvin* (1958), 15 D.L.R. (2d) 120, 25 W.W.R. 664 (Man. C.A.).

[24] See *Construction Lien Act, 1983*, S.O. 1983, c. 6, s. 52, which, *inter alia*, provides in s.s. (3) that a master "to whom a reference has been directed has all the jurisdiction, powers and authority of the court to try and completely dispose of the action and all matters and questions arising in connection with the action ...".

[25] See *Courts of Justice Act, 1984*, S.O. 1984, c. 11, ss. 89-90.

[26] R.S.O. 1980, c. 296, s. 32. See, also, s. 33 with respect to when service by mail is deemed to be effective. Note, too, that while service by mail under the *Family Law Act, 1986*, S.O. 1986, c. 4, s. 22(2), is deemed to be effective on the fifth day after mailing, s. 22(3) provides that, "[w]hen a person exercises a power of sale against property that is a matrimonial home, sections 32 and 33 of the *Mortgages Act* apply and subsection (2) does not apply".

[27] See, generally, draft Act, s. 7.1.

For our purposes, it is essential to mention only the main elements of our proposals respecting service, for these would involve some change in the law. We first recommend that, generally, documents should be served either personally, in the manner provided by the Rules of Civil Procedure, or by mail.[28] In connection with service by mail, the Commission is of the view that a distinction should be made between service of documents on a borrower, on a lender, and on any other person.

In order to reduce the costs and inconvenience to borrowers, we recommend that documents to be served by mail on the lender should be sent by registered mail to the lender's designated address for service set out in the security agreement or, if the borrower knows that the designated address is no longer valid, to the branch or other office of the lender where the borrower normally makes payment or to such other address of the lender known to the sender.[29]

Where a document is to be served on the borrower by mail, we believe that service by both registered and prepaid first class mail is essential in order to ensure that important notices come to the borrower's attention. For example, in times of financial distress, a borrower may otherwise attempt to avoid service where service is by registered mail alone. Accordingly, we recommend that service on the borrower should be by both registered and prepaid first class mail to the borrower's designated address for service set out in the security agreement, or to the borrower's last known address, if the sender knows that the designated address is no longer valid, or to the secured property, if the sender knows that the first two addresses are no longer valid.[30]

Where a document is to be served by mail on a person other than a lender or a borrower, it should be sent both by registered and by prepaid first class mail to the person's designated address or, if the sender knows the designated address is no longer valid, to a branch or other office of the person or to such other address of the person known to the sender.[31]

3. COSTS OF AN APPLICATION UNDER THE *LAND SECURITY ACT*

We are of the view that, generally, where an application is made under the *Land Security Act*, the Rules of Civil Procedure[32] governing costs should apply. However, to ensure the most expeditious and least expensive resolution of such applications, we make the following recommendations.

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[28] *Ibid.*, s. 7.1(2).

[29] *Ibid.*, s. 7.1(5).

[30] *Ibid.*, s. 7.1(3).

[31] *Ibid.*, s. 7.1(6).

[32] *Supra*, note 2, R. 57.

In order to avoid the prospect of a further application for the assessment of costs,[33] we recommend that the court should fix the costs of an application brought under the Act at the time of the hearing, unless in the circumstances it would be inappropriate to do so.[34]

It will be recalled that, under a number of our recommendations, a borrower is entitled to bring an application where a lender has failed to fulfil an obligation owed to the borrower under the Act. For example, an application may be brought where a lender has ignored a borrower's request for a statement of account or a discharge. The Commission believes it is possible, and desirable, to encourage lenders to comply with their obligations under the Act and to discourage unnecessary applications to the court by means of a costs sanction. Accordingly, we recommend that, where an application is brought because of a lender's failure, without reasonable excuse, to comply with his or her statutory obligations respecting the provision of a statement of account[35] or a discharge,[36] prepayment of the loan,[37] or the assumption of the security agreement,[38] the court should award costs of the application to the applicant on a solicitor and client basis, to be paid forthwith.[39]

Finally, we recommend that the court should be empowered to order that the costs be added to, or subtracted from, the amount due under the security agreement.[40]

4. THE LAND SECURITY COMMITTEE

As indicated earlier,[41] in the course of its study of the law of mortgages, representatives of the Commission consulted extensively with many persons and groups knowledgeable in the law and practice relating to mortgage financing. That process included formal consideration by an Advisory Board, comprising representatives of all segments of the community affected by mortgage law, of the initial recommendations for reform proposed by the Research Team. This manner of proceeding was, we believe, most effective as a means of identifying weaknesses and inadequacies in the present law and, later, in the reasoning that had led to the reform proposals put forth by the Research Team. In our opinion, there can be no substitute for this type of consultation and review process. We have arrived at this conclusion notwithstanding that, in many areas, our consultants could offer only tentative advice, since they were unsure about how specific reform proposals would operate in practice.

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[33] *Ibid.*, R. 58.

[34] Draft Act, s. 7.3(1).

[35] *Ibid.*, s. 3.15.

[36] *Ibid.*, s. 3.17.

[37] *Ibid.*, s. 5.4.

[38] *Ibid.*, s. 5.5.

[39] *Ibid.*, s. 7.3(2).

[40] *Ibid.*, s. 7.3(3).

[41] See *supra*, ch. 1, sec. 1(b).

We believe that the reform package that we have recommended in this Report will elicit substantial support from all persons affected by the law relating to land security. At the same time, we appreciate that many priorities press on government, and we do not anticipate that there could realistically be a formal governmental review of the practical operation of any new legislation on an annual or regular periodic basis.

Those involved in land security financing, who daily see and deal with its routine and unexpected problems and complexities, have a continuing interest in the subject and, for the most part, are ideally situated to view existing law and practice critically and to offer proposals for reform. In many areas in which we anticipate the need for adjustments as a result of practical experience, we have recommended a regulation-making power. In order to inform that regulation-making power, we recommend that a permanent specialized ministerial committee, dealing exclusively with matters relating to land security, should be established. The committee should meet on a regular basis, and more frequently in the early years after implementation of our reform proposals, in order to monitor, and to make recommendations concerning, the law and practice pertaining to land security transactions.

The committee should be constituted in time to review drafts of our proposed new *Land Security Act* before its enactment. In addition, the committee should be involved in reviewing the various forms recommended to be prescribed under the proposed Act and in preparing the "information booklet" of questions that will be made available to prospective borrowers in order to permit them to determine both where they will obtain financing and the desirability of particular offers to finance.

The Commission does not think it appropriate nor realistic to deal in detail with the manner and term of appointment of committee members. However, if the committee is to be effective, it would have to be composed of experts broadly representative of the community affected by land security law and practice, and we so recommend. Furthermore, we recommend that the committee should also include government officials representing ministries whose supervisory responsibilities relate to matters pertaining to land security transactions. This combination of private and public sector consultation and review would, we believe, be most efficacious in avoiding or resolving any problems that might arise as a result of the enactment of a new legislative regime.

The concept of an ongoing and expert ministerial committee to inform those involved in administering new legislation is, of course, not new. Such a body exists with respect to the *Personal Property Security Act*.[42] In this area, we believe that problems have been identified, and reform has been undertaken, more quickly than would have been the case without the active involvement of a monitoring committee.

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[42] R.S.O. 1980, c. 375. See, also, a somewhat similar body with respect to the *Statutory Powers Procedure Act*, R.S.O. 1980, c. 484, Part II.

5. CONSEQUENTIAL AMENDMENTS AND TRANSITIONAL PROVISIONS

In this section, we shall deal with two matters: first, the issue of consequential amendments to existing legislation arising from changes that would be effected by our proposed new Act; and, secondly, whether the new Act should contain any transitional provisions governing the effect of that Act on existing land security agreements.

As to the issue of consequential amendments, it is clear that a number of statutory amendments will be required in order to implement the Commission's proposals, particularly the recommendation that mortgage law should be centralized in the proposed *Land Security Act*. For example, the disclosure requirements to be imposed upon mortgage brokers would be dealt with in the *Land Security Act*, in which the definition of lender would include a mortgage broker, rather than in the *Mortgage Brokers Act*.[43]

Other necessary statutory amendments have been identified throughout the Report and specific recommendations with respect to such amendments have been made in the context of the particular reform proposal. For example, we have recommended that section 6(3) of the *Land Registration Reform Act, 1984*[44] should be repealed, in order that the courts will not use equitable rules to supersede the provisions of the *Land Security Act*, which are intended as a codification of the matters addressed in that Act.

There exist as well literally hundreds of statutes and regulations that contain provisions that involve or refer to mortgages or other security interests in land. We are satisfied that, with the advice of the Research Team and Advisory Board, we have identified in this Report the major policy issues and matters requiring reform and statutory amendment and that the vast majority of any other provisions would require amendment only with respect to terminology. We are confident that such other consequential statutory amendments as may be required would be best identified and implemented by the Ministry responsible for the operation of that particular statute.

The second matter concerns whether there is a need for transitional provisions, dealing with the effect of any new land security legislation on existing agreements. In this connection, it should be borne in mind that our proposals for reform would change, for example, a lender's obligations of disclosure at the beginning of the borrower-lender relationship, the substantive rights of the parties during the ongoing relationship, and the remedies available upon default by a borrower.

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[43] R.S.O. 1980, c. 295. See draft Act, s. 4.1(b).

[44] S.O. 1984, c. 32.

The Commission recommends that the proposed disclosure requirements should not apply where the security agreement was registered before the date on which our proposed Act comes into force.[45] But we do believe that it is justifiable to impose on lenders a requirement that they comply with disclosure obligations that arise after the date that our proposed Act comes into force, and we so recommend.[46] Where, for example, a borrower and a lender have already executed a security agreement when the Act comes into force, it would clearly be unreasonable to require the lender to comply with the proposed pre-contract disclosure requirements or suffer the consequences of his or her failure to do so. However, we do intend that, in such a case, the lender should comply with disclosure requirements such as those that arise on the borrower's default, where the default arises after the effective date of the legislation.

Seemingly more difficult issues are raised by our recommendations in the other two areas. It might be argued that, aside from the disclosure obligations described above, the parties to land security agreements that pre-date the new Act should be governed by current law and that the substantive rights provided under the Act should become applicable only to agreements entered into, or perhaps renewed, after the effective date of that Act.

We do not consider any such transitional provisions necessary or desirable. While it is true that our proposals, if implemented, would introduce several rights and remedies that differ from those now enjoyed, we do not believe that any of them would involve the imposition of unfair or surprising obligations on the parties. For one thing, our proposals generally would not have a significant effect on commercial arrangements. Moreover, insofar as residential land security agreements are concerned, the proposals largely mirror existing practice. Where legislation reflecting the Commission's recommendations would alter existing law or practice, we are of the view that such legislation ought to govern: as a matter of principle, these new provisions should not admit of contracting out. Accordingly, in our opinion, one of the strongest arguments against retroactive reform, namely, that such reform removes any opportunity for the parties to structure their affairs in light of existing law, is not tenable in these cases.

In our view, the proposed reforms would introduce better remedial and other measures in the land security context, in terms of both efficiency and fairness. Our recommendations would have no significant economic impact, other than in the case of overreaching by one of the parties. While it is true that the remedies we have proposed would require methods of realization on security that are somewhat different than those now employed, the advice that we have received from the Advisory Board and those experts with whom the Research Team consulted was to the effect that the revised realization procedure would be welcomed by both lenders and borrowers.

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[45] Draft Act, s. 7.7(2).

[46] *Ibid.*, s. 7.7(3).

Accordingly, we recommend that, subject to our earlier proposals respecting the applicability of the disclosure provisions, the proposed Act implementing our recommendations should apply to all land security agreements in existence on the date on which the legislation comes into force.[47]

RECOMMENDATIONS

The Commission makes the following recommendations:

1. (1) Unless and until it is shown that the application procedure under the Rules of Civil Procedure is unequal to the task of providing an expeditious, effective, and inexpensive means of resolving disputes in the context of land security arrangements, that procedure, as modified by paragraph (2), should continue to be used to deal with all issues recommended to be dealt with by application to the court.

   (2) Applications pursuant to the proposed *Land Security Act* should be heard not only by a judge or local judge of the Supreme Court of Ontario, as is now the case under the Rules of Civil Procedure, but also by a master of the Supreme Court.

   (3) The legislative mechanism empowering a master to hear such applications should be designed to meet any constitutional objections raised by section 96 of the *Constitution Act, 1867*.

2. (1) Documents should be served either personally, in the manner provided by the Rules of Civil Procedure, or by mail.

   (2) In connection with service by mail:

   (a) documents to be served on the lender should be sent by registered mail to the lender's designated address for service set out in the security agreement or, if the borrower knows that the designated address is no longer valid, to the branch or other office of the lender where the borrower normally makes payment or to such other address of the lender known to the sender;

   (b) documents to be served on the borrower should be sent by both registered and prepaid first class mail to the borrower's designated address for service set out in the security agreement, or to the borrower's last known address, if the sender knows that the designated address is no longer valid, or to the secured property, if the sender knows that the first two addresses are no longer valid; and

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[47] *Ibid.*, s. 7.7(1).

(c) documents to be served by mail on a person other than a lender or a borrower should be sent both by registered and by prepaid first class mail to the person's designated address or, if the sender knows the designated address is no longer valid, to a branch or other office of the person or to such other address of the person known to the sender.

3. (1) The court should fix the costs of an application brought under the *Land Security Act* at the time of the hearing, unless in the circumstances it would be inappropriate to do so.

(2) Where an application is brought because of a lender's failure, without reasonable excuse, to comply with his or her statutory obligations respecting the provision of a statement of account or a discharge, prepayment of the loan, or the assumption of the security agreement, the court should award costs of the application to the applicant on a solicitor and client basis, to be paid forthwith.

(3) The court should be empowered to order that the costs be added to, or subtracted from, the amount due under the security agreement.

4. (1) A permanent specialized ministerial committee, dealing exclusively with matters relating to land security, should be established.

(2) The committee should meet on a regular basis, and more frequently in the early years after implementation of the Commission's reform proposals, in order to monitor, and to make recommendations concerning, the law and practice pertaining to land security transactions.

(3) The committee should be constituted in time to review drafts of the proposed new *Land Security Act* before its enactment. In addition, the committee should be involved in reviewing the various forms recommended to be prescribed under the proposed Act and in preparing the "information booklet" of questions that should be made available to prospective borrowers to enable them to determine both where they will obtain financing and the desirability of particular offers to finance.

(4) The committee should be composed of experts broadly representative of the community affected by land security law and practice, as well as government officials representing ministries whose supervisory responsibilities relate to matters pertaining to land security transactions.

5. (1) The disclosure requirements should not apply where the security agreement was registered before the date on which the proposed *Land Security Act* comes into force.

(2) Lenders should be required to comply with disclosure obligations that arise only after the date that the proposed Act comes into force.

(3) Subject to paragraphs (1) and (2), the *Land Security Act* should apply to all land security agreements in existence on the date on which the legislation comes into force.

SUMMARY OF RECOMMENDATIONS

The Commission makes the following recommendations:

CHAPTER 1: GENERAL INTRODUCTION

1. A new *Land Security Act* should be enacted. All substantive rules governing security interests in land should be included in that Act.

CHAPTER 2: THE CREATION, NATURE AND ENFORCEABILITY OF SECURITY AGREEMENTS

2. (1) Subject to paragraph (2), the *Land Security Act* should apply to every transaction, regardless of its form, that is intended to create a security interest in land, including a security agreement, mortgage, charge, debenture, trust deed, and any transaction in which an interest in or title to the land is retained by the transferor after the transferee has taken possession of the land, but should not apply to non-consensual liens and similar interests in land, such as vendor's liens and construction liens.

   (2) It should no longer be possible to create a security interest in land by means of a deposit of title deeds.

3. The *Land Security Act* should constitute a complete code. In order to avoid reintroducing into the law certain legal and equitable rules that should be abolished, the Act should not include a provision akin to section 6(3) of the *Land Registration Reform Act, 1984*.

4. In the context of land security transactions, the term "security agreement", rather than "mortgage", should be used. The term should encompass a writing that creates or provides for a security interest in land, and should include a charge under the *Land Titles Act* and a mortgage and any collateral agreement relating to the security interest other than mortgage insurance, but should not include a rent charge.

5. (1) A security interest should not be enforceable by or against a borrower unless the borrower has signed a security agreement that contains an adequate description of the land, acknowledges the lender's security interest, and is in registrable form.

   (2) Where the security agreement is not in registrable form, but otherwise satisfies the requirements of paragraph (1), the court, on the application of the lender, should compel the borrower to do what is necessary to put the security agreement in registrable form.

(3) Where the security agreement is unenforceable by reason of any defect other than that it is not in registrable form and where it appears to the court to be just, the court, on the application of the lender, should have the power to compel the borrower to sign a security agreement in registrable form.

CHAPTER 3: THE ABOLITION OF ANOMALIES AND ANACHRONISMS

6. The doctrine of consolidation should be abolished.

7. The doctrine of tacking should be abolished.

8. (1) Subject to paragraph (3), no term contained in a security agreement should be unenforceable by reason only that it is a clog on the equity of redemption.

(2) For greater certainty, the proposed *Land Security Act* should provide specifically that no term of any security agreement should be unenforceable by reason only that:

(a) the lender has a right to share in any profits earned by the borrower from any enterprise or transaction financed by the loan; or

(b) the amount to be repaid as principal when the security agreement is due, or otherwise on redemption, includes part of any increase in the value of the land, or is increased in proportion to any changes in any index or other measure reflecting the rate of inflation, between the date of the agreement and the date of repayment of the amount due or the date of redemption.

(3) Subject to paragraph (4), where the security agreement involves a protected borrower (see chapter 4), no provision that purports to give the lender a right to purchase the property on or before redemption, or on default, should be enforceable.

(4) Legislation implementing the recommendation in paragraph (3) should not apply where, at the time the security agreement is signed:

(a) the borrower is either employed, or is intending to become employed, by the lender or a person affiliated with the lender; and

(b) the terms of the agreement that entitles the lender to purchase the secured property are fair and reasonable, having regard to the circumstances of the employment or intended employment.

CHAPTER 4: THE PROTECTED BORROWER

9. The *Land Security Act* should create a class of borrower, called a "protected borrower", in respect of whom special rights should be conferred.

10. The term "protected borrower" should be defined to mean:

    (a) a borrower who resides in secured property that is a single family residence or residential unit, such as a condominium, whether it is a primary residence or a secondary residence, and regardless of the size or purpose of the loan;

    (b) a borrower who resides in secured property that is either a farm, a commercial or manufacturing enterprise, or a multi-unit building of not more than five units, where such property secures a loan that does not exceed a specified amount, which should be prescribed by regulation and subject to adjustment on a regular basis to reflect inflation and market trends;

    (c) a guarantor of a loan that is secured by exclusively or partially residential property, as described above, if the guarantor occupies the residence;

    (d) a spouse of a borrower and a spouse of a guarantor of the loan, as the term "spouse" is defined in section 1(1) of the *Family Law Act, 1986*, where the borrower or guarantor is a protected borrower, if the spouse occupies the premises as a residence; or

    (e) a borrower who gives land as security for a loan in an amount less than an amount prescribed by regulation ($150,000 may be an appropriate amount), irrespective of the nature of the secured property and irrespective of the purpose of the loan.

CHAPTER 5: PRIORITIES AMONG SECURED CREDITORS

11. (1) Subject to paragraphs (2) and (3), the following rules should govern a lender's priority for advances made pursuant to a registered security agreement that expressly contemplates future advances:

    (a) where the amount loaned is expressed to be a fixed amount, the priority should be for the amount outstanding under the security agreement, so long as the total amount advanced does not exceed the express amount under the agreement;

    (b) where the agreement contemplates future advances on a revolving basis, the lender should have priority for the amount outstanding, up to the maximum amount of credit expressed in the agreement, even though the cumulative total of advances made under the agreement exceeds the amount for which the agreement is expressed to be a security; and

(c) in the cases contemplated by subparagraphs (a) and (b), the lender should have priority whether or not he or she has notice of a subsequent encumbrance.

(2) The recommendations in paragraph (1) should be subject to Part XI of the *Construction Lien Act, 1983*.

(3) The recommendations in paragraph (1) should be subject to a further exception respecting payments made to protect the secured property. That is, a lender should be secured and have priority for future advances, even though the security agreement does not expressly contemplate future advances and even though the advances exceed the total express loan amount, where those amounts are advanced for the reasonable protection of the secured property, for example, for such expenses as property taxes, insurance premiums, condominium maintenance fees, and commercially reasonable repairs.

12. With respect to the situation where, in the case of a loan contemplating future advances, the lender refuses to make such advances:

(a) the lender's priority should be fixed at the date of his or her refusal to make further advances and should not exceed the amount actually outstanding under the security agreement;

(b) in order to establish the actual amount of the lender's priority to the satisfaction of a prospective subsequent lender, the following rules should apply:

(i) the borrower should be entitled to register a notice in prescribed form stating that the lender has refused to make further advances, and stating the amount of the outstanding indebtedness;

(ii) the notice should be served on the lender (see chapter 11, Recommendations 159(1) and (2)(a));

(iii) the lender should be entitled to dispute the borrower's notice concerning the lender's refusal to make further advances or concerning the amount stated to be due under the security agreement by registering against title a notice of dispute, as prescribed by regulation;

(iv) the notice should be served on the borrower (see chapter 11, Recommendations 159(1) and (2)(b));

(v) if the lender fails to register a notice of dispute within ten business days after registration of the notice by the borrower, the information contained in the borrower's notice should be deemed to be correct and binding on the lender for the purpose of limiting the lender's priority;

(vi) where the lender registers a notice of dispute, the matter should be resolved by application to the court; and

(vii) either party should be entitled to register the court order, and that order should be conclusive of the matters determined therein; and

(c) where the notice by the borrower or the lender contains a statement that the maker of the statement knows or ought to know is incorrect, that party should be liable to any person for any loss or damage caused thereby.

13. Where a borrower is a protected borrower, and where the security agreement expressly contemplates renewal upon maturity of the agreement, the lender should be entitled to priority for the renewed amount, including any increased interest amount, so long as the lender has renewed the security agreement on the terms expressly set out in the agreement.

14. A clause in a security agreement should be void if it requires, or entitles the lender to require, the borrower to pay the amount due under the agreement where a prior security agreement is renewed in accordance with its terms.

15. Priority problems raised by the existence of unregistered liens in favour of the Crown or a public body for an amount owing to it by the owner of land, dealt with in the Commission's 1971 *Report on Land Registration*, should be considered by the Land Registration Management Committee of the Ministry of Consumer and Commercial Relations.

CHAPTER 6: SUBSTANTIVE RIGHTS OF THE PARTIES

16. The prepayment rights of a borrower who is not a protected borrower should be governed by the terms of the security agreement.

17. A borrower who is a protected borrower should be entitled to prepay the loan at any time, provided that the lender is fully compensated for the actual damages incurred as a result of the prepayment. Full compensation to the lender should include not only compensation for loss of interest where the interest rate at the date of prepayment has

fallen ("prepayment compensation"), but also the transaction costs involved in making a new loan.

18. The *Land Security Act* should provide a formula for determining the value of such prepayment compensation to the lender. The compensation should represent the present value of the difference between the amount the lender would have earned under the security agreement, and the amount that, at current market rates of interest (the "current interest rate"), the lender would now earn in a substitute investment.

19. (1) The *Land Security Act* should specify how the current interest rate should be calculated for the purpose of the formula used to determine the appropriate prepayment compensation.

    (2) Ordinarily, the current interest rate that should be used in the proposed formula should be the current rate for the lender's potential substitute investment.

    (3) Alternatively, the parties should be entitled to provide in the security agreement that, for the purpose of prepayment of the agreement, the current interest rate shall be calculated with reference to a lender that is in the business of making loans secured by security agreements similar to the borrower's security agreement.

    (4) If the lender does not have a current rate for a potential substitute investment at the time of prepayment, the market rate should be used.

20. The amount of compensation for the transaction costs incurred by a lender (see Recommendation 17) should be the lesser of one month's interest or an amount prescribed by regulation.

21. Any dispute regarding the amount due under the security agreement or the amount of compensation to which the lender is entitled should be resolved by an application to the court.

22. With respect to the method of exercising the protected borrower's proposed right of prepayment, the borrower should be entitled, by notice, to require from the lender a statement of account, in prescribed form, as proposed in Recommendations 38 *et seq*.

23. The borrower's request for a statement of account should specify the statement of account is for the purpose of prepayment and should be served on the lender in the manner proposed in chapter 11 (see Recommendation 159(1) and (2)(a)).

24. The borrower's request for a statement of account should also specify the date upon which the statement is to be effective, which should be a date not more than thirty days after the date of the notice.

25. The prepayment statement of account should be provided within fifteen business days after the date on which service of the notice from the borrower requesting the statement is effective. If the lender fails to provide the statement as required, the borrower should be entitled to have recourse to the procedure recommended below with respect to obtaining a discharge (see Recommendations 33-34).

26. In addition to the information that should be contained in a conventional statement of account (see Recommendation 41), for the purpose of prepayment the statement should also show the prepayment compensation and transaction costs required to be paid, as well as the method by which such amounts were calculated.

27. Prepayment should not merely suspend the running of interest, as is now the case under section 17 of the *Mortgages Act* and section 10 of the *Interest Act*. Rather, upon being paid or tendered the outstanding principal and compensation, in the amount determined, the lender should be required to give the borrower a discharge in registrable form at no cost to the borrower.

28. Sections 16 and 17 of the *Mortgages Act* should be repealed and the Parliament of Canada should be requested to amend section 10 of the *Interest Act* so that it does not apply to Ontario.

29. (1) As soon as the obligation whose performance is secured by the security agreement is performed, or the borrower is otherwise entitled to a discharge, the lender should be required to prepare a discharge of the security agreement in registrable form, as well as a release of insurance and discharge of any collateral security, in registrable form, without charge to the borrower.

    (2) The lender should serve the discharge and other documents on the borrower within ten business days of the date on which the borrower is entitled to the discharge.

30. The borrower should continue to have the responsibility of registering the discharge.

31. The discharge should be accompanied by a notice stating clearly that the discharge should be registered in the appropriate land registry office, and setting out the address of that office.

32. Where the lender fails, without reasonable excuse, to prepare and deliver the discharge of the security agreement and any release of insurance and discharges of collateral security within the stipulated time, the lender should be liable for any loss or damage caused thereby.

33. Where the lender fails, without reasonable excuse, to prepare and deliver the discharge and other documents, as proposed above, the borrower should be entitled to serve on the lender a written request for the discharge, and the lender should be required to deliver the discharge and other documents to the borrower within ten business days after receipt of this request.

34. (1) If the lender fails to make such delivery, the borrower should be entitled to apply to the court for relief.

(2) Where the court is satisfied that all money due under the agreement has been paid and all covenants have been performed, the court should have the power either to order the lender to provide a discharge of the security agreement in registrable form, a release of insurance, and a discharge of any collateral security in registrable form, or to make an order discharging the security agreement, releasing any insurance, and discharging any collateral security.

35. (1) When a borrower or any person entitled to pay off a security agreement desires to do so and the lender cannot be found, or where from any other cause a proper discharge cannot be obtained, or cannot be obtained without undue delay and expense, on the application of the borrower or the person entitled to pay off the security agreement, the court should be empowered to direct payment into court of the amount due under the security agreement and to make an order discharging that agreement, releasing any insurance on the property, and discharging any collateral security.

(2) The money paid into court should be paid out to the lender or as the court may direct.

(3) The court should be empowered to require notice to be given to the lender or those claiming under the lender, either before or after making the order, by advertisement or in any other manner as is considered proper.

36. Where an issue arises as to who is entitled to receive payment or as to the reasonableness or amount of the payment, the court should be empowered, as a condition of making an order, to require payment into court of a sum in excess of the amount admitted to be due and to answer any claim by the lender for subsequent interest and costs. The sum paid into court should be subject to the further order of the court, and the court should be empowered to require payment into court of an additional sum.

37. Where the court makes an order discharging the security agreement, releasing any insurance, and discharging any collateral security, the borrower should be entitled to register the order in the proper land

registry office, and the registered order should be conclusive of the matters determined in the order and should have the same effect as the registration of a certificate of discharge signed by the lender.

38. (1) The borrower and any subsequent encumbrancer who has the right to remedy the borrower's default should be entitled, by a notice in writing, to require a lender to provide a statement of account at any time.

(2) The notice should be served on the lender in the manner proposed in chapter 11 (see Recommendations 159(1) and (2)(a)).

(3) The notice should state that the statement of account is required for the purpose of prepayment, if such is the case, state the date upon which the statement of account is to be effective, which should be a date not more than thirty days after the date of the notice, and enclose the prescribed fee.

39. The lender should be required to serve the statement of account on the person serving the notice within fifteen business days after the date on which service of the notice is effective.

40. (1) The borrower should be entitled to receive one free statement of account within every twelve month period after the date of the execution of the security agreement. Subsequent encumbrancers, however, should be required to pay the prescribed fee in all cases.

(2) Where the borrower requests any additional statements within the twelve month period, he or she should be required to pay, in advance, the lender's reasonable costs of producing each additional statement. A maximum charge for such a statement should be established by regulation and the initial maximum amount should be $25.

41. (1) For the purpose of paragraph (2), "period" should be defined to mean:

(a) the period between the date the last amount on account of principal was advanced to the borrower under the security agreement and the date of the statement of account, if no statement of account has been previously provided to the borrower; or

(b) the period between the date of the statement of account most recently provided to the borrower and the date of the requested statement of account.

(2) While the proposed statement of account need not be in any particular form, it should be in writing and should set out, in plain language, the following information:

(a) the principal amount due at the beginning of the period;

(b) the amount of payments credited during the period;

(c) the apportionment of payments credited during the period on account of principal, interest, and taxes, or any other matters;

(d) the amount of any payments made by the lender and charged to the security agreement during the period and indicating the nature of the payments;

(e) the status of the tax or any other accounts maintained by the lender in respect of the security agreement at the end of the period;

(f) the principal amount due at the end of the period and the method by which the amount was calculated;

(g) the interest rate or rates charged on the security agreement during the period, including the rate on the date of the statement of account;

(h) the amount of any charge assessed against the borrower arising out of the borrower's default, if any, and the nature of the charge;

(i) the amount, if any, required to be paid to bring the security agreement into good standing;

(j) if the statement of account is required for the purpose of prepaying the security agreement, the compensation required to be paid and the method by which the compensation was calculated;

(k) if the effective date specified in the request for a statement of account requires the lender to assume that certain payments will be made before the effective date, a statement that it is correct only if such payments are duly made; and

(l) such other information as may be prescribed.

42. **The obligation to provide a statement of account upon request should apply to all lenders, whether or not the borrower is a protected borrower.**

43. **The statement of account should be effective as of the date specified in the notice requesting the statement, which would be a date not more than thirty days after the date of the notice (see Recommendations 24 and 38(3)).**

44. The statement of account should bind the lender in favour of the person requesting the statement and any person to whom the lender might reasonably expect such person to provide the statement, if the statement is reasonably relied upon to the recipient's detriment.

45. (1) Subject to Recommendation 41(k), the lender should not be entitled to qualify the statement of account, or obtain a waiver of liability through the use of a disclaimer or an "errors and omissions excepted" clause, where the statement of account has been provided by the lender after a written request has been made by the borrower or subsequent encumbrancer.

(2) The lender should be entitled to include an "errors and omissions excepted" clause on an informal, unsolicited statement, provided that the statement also clearly indicates that it is an informal, non-binding statement only and that a borrower or subsequent encumbrancer who wishes to rely on the completeness and accuracy of a statement must make a written request to the lender for a formal statement of account that will bind the lender.

46. (1) Except where a statement of account is issued by the court (see Recommendation 47(2)), the lender should be entitled to notify a person who has received a statement that an error has been made, and to provide that person with an amended statement of account.

(2) However, the lender should remain liable for any loss that has been suffered as a result of reasonable reliance on the original statement.

(3) The onus should be on the lender to determine from the person requesting the statement whether an incorrect statement has been given to a third party and to deliver to that party an amended statement. Until the lender does so, the lender's potential liability to the third party should continue.

(4) At the lender's request, any person who has received a statement of account should be required to provide forthwith to the lender the names and addresses of those persons who he or she knows or ought to know have received a copy of a statement of account.

(5) Where the person who has received a statement of account fails to comply with the preceding obligation or is negligent in providing the requisite information, the lender should remain liable directly to a third party who has suffered a loss after reasonably relying on an incorrect statement. However, the lender should be able to seek indemnification from the person from whom the information has been requested for any damages paid by the lender to that party.

47. (1) If the lender fails to produce a binding statement of account within the proposed fifteen day period (see Recommendation 39), the borrower should be entitled to apply to the court to obtain the statement.

    (2) The court should be empowered either to order the lender to prepare and issue the statement of account or to prepare and issue the statement itself.

48. A dispute regarding the accuracy or sufficiency of the statement of account should be resolved by application to the court of any interested person.

49. (1) Where the lender fails, without reasonable excuse, to deliver the required statement:

    (a) the lender should be liable, on the application of the person requesting the statement, for any loss or damage caused to the applicant, and

    (b) the lender should be guilty of an offence and subject to a fine of not more than $2,000.

50. Recommendations 51-54, dealing with due-on-sale clauses, should apply only to security agreements where one of the parties is a protected borrower.

51. A lender should be entitled to include a due-on-sale clause in the security agreement, subject to the proviso that, where a security agreement contains a due-on-sale clause, the borrower, upon a good faith sale of the secured property to an unrelated purchaser, should have the right to prepay the loan without any compensation to the lender.

52. The term ''unrelated purchaser'' should be defined to mean a purchaser who is an individual, or a corporation controlled directly or indirectly by an individual, where the individual is not connected to the borrower by blood relationship, marriage, or adoption.

53. A lender should be entitled to see, on demand, the agreement of purchase and sale and the affidavit of transfer that is required under the *Land Transfer Tax Act*.

54. Any dispute regarding the right to prepay should be resolved by application of either party to the court.

55. (1) In a security agreement involving a protected borrower, a clause should be void and unenforceable where that clause gives the lender the option to call the loan if:

(a) the borrower commences negotiations for a sale or subsequent encumbrance of the property;

(b) the borrower enters into a subsequent security agreement;

(c) the secured property is encumbered by an interest that is subsequent in priority to the security interest;

(d) the borrower defaults under a subsequent encumbrance; or

(e) a prior security agreement is renewed in accordance with its terms.

(2) The recommendation in paragraph (1) should not be interpreted to prevent a lender from calling the loan in cases where a statutory lien or other interest is registered against the secured property after the lender's security agreement, but has priority over the lender's interest.

56. A borrower should not be required to insure the secured property for an amount in excess of the replacement value of the buildings and fixtures on that property.

57. (1) Where the security agreement is not a residential security agreement:

(a) unless the security agreement provides to the contrary, all proceeds payable to a borrower on an insurance of the secured property should, if the lender so requires, be applied by the borrower in repairing or replacing the buildings and fixtures in respect of which the proceeds are received; and

(b) subject to any obligation to the contrary imposed by law or by special contract, a lender should be entitled to require proceeds payable on an insurance of the secured property to be paid directly to the lender.

(2) Where the security agreement is a residential security agreement:

(a) subject to subparagraphs (b) and (c), the protected borrower should be entitled to require that the insurance proceeds be applied towards repair or replacement of the damaged premises, notwithstanding any agreement to the contrary that is entered into prior to the damage or loss;

(b) the protected borrower and the lender should be entitled to agree that the insurance proceeds shall be paid to and held by the lender in trust, to be disbursed in making such repair or replacement; and

(c) after the damage or loss has arisen, the protected borrower should be entitled to agree in writing that the insurance proceeds be paid directly to the lender.

CHAPTER 7: DISCLOSURE OF INFORMATION TO BORROWERS

58. The recommendations respecting disclosure at the advertising or first inquiry stage and at the commitment stage (see Recommendations 59-63) should apply only where the prospective borrower is a protected borrower.

59. (1) At the advertising or first inquiry stage, any representation by or on behalf of a lender of the rate to be charged on a loan secured by land should disclose the cost of borrowing, expressed as an annual percentage rate or range of rates applicable to the class of loan being advertised, and the nature, but not necessarily the amount, of other expenses not included in the cost of borrowing, that must be paid by the protected borrower.

(2) The disclosure requirement proposed in paragraph (1) should apply whether the representation is made in response to an oral or written inquiry or in an advertisement.

60. A lender should be free to disclose information or explanations additional to that contained in any advertisement or statement, if the additional information or explanation is not stated, utilized, or placed so as to contradict, obscure, or distract attention from the information required to be disclosed.

61. A lender should not be bound to enter into a security agreement with the borrower that conforms with the lender's representations under Recommendation 59(1) by reason only that the lender has made disclosure in compliance with the above recommendations.

62. (1) In order to ensure that a prospective protected borrower is capable of making informed comparisons between lenders, a list of suggested questions that the borrower might ask a lender should be prepared by the proposed permanent specialized ministerial committee dealing with security matters (see chapter 11, Recommendation 161).

(2) The list should specifically address those features of a security agreement with which many borrowers might not be familiar, such as rights of prepayment or due-on-sale clauses, and optional terms, such as renewal rights, and the relative costs of these features or terms.

(3) The list should be made widely available through libraries, real estate offices, and in such other ways as consumer information is now made available about such matters as home insulation, home security, and public health.

(4) A lender upon whom there is an obligation to disclose should be required to make the proposed information questionnaires in the prescribed form available to prospective borrowers at the lender's places of business, at no cost to the borrower, and to give a copy of the information questionnaire to the borrower at the lender's first opportunity.

63. (1) At the commitment stage, the lender should be required to provide a protected borrower with a disclosure statement in a prescribed form that would contain information of the type that satisfies the existing requirements of Schedule II of the regulations under the *Bank Act*, but modified to provide information with respect to price level adjustment agreements and shared appreciation agreements.

(2) The proposed disclosure statement should be given to the protected borrower at the time when the lender communicates to the borrower the terms on which the lender offers to take security from the borrower, but in any event not less than five days before the borrower is required to accept the offer. However, subject to the terms of the disclosure statement, the borrower should remain free to accept the commitment offer at any time after receiving the disclosure statement.

(3) Where the terms of the offer specified in the commitment letter differ from those specified in the disclosure statement, the terms of the disclosure statement should govern.

64. The recommendations respecting disclosure at the execution stage (see Recommendation 65) should apply in all cases, whether or not the borrower is a protected borrower.

65. (1) On or before the date when the borrower signs the *Land Registration Reform Act, 1984* charge in Form 2, the lender should be required to give to the borrower a copy of the security agreement, where it is appended as a schedule to Form 2, or a copy of the standard terms filed by the lender with the Director of Land Registration.

(2) In the event of any discrepancy between the terms of the disclosure statement upon commitment and the security agreement, the following rules should apply:

(a) as between the parties, the individual terms of each document most beneficial to the borrower should prevail; and

(b) the terms of the security agreement should govern the rights of all other persons.

66. (1) Every residential security agreement should contain terms, prescribed by regulation, that disclose certain rights, obligations, and remedies of a lender and a protected borrower that are not subject to waiver or abridgement prior to default.

(2) The prescribed mandatory terms should be inserted in the residential security agreement under the caption to which the subject matter of each individual term relates. The lender should be entitled to integrate the mandatory terms with other provisions in the agreement, provided that such integration does not contradict, obscure, or distract attention from the substance of the terms. Similarly, the lender should be entitled to alter the mandatory terms where the security agreement uses pronouns or other descriptions in referring to the lender, borrower, or agreement that differ from those used in the mandatory terms.

(3) Section 7(1) and (5) of the *Land Registration Reform Act, 1984* should be repealed.

67. Prior to exercising any remedy against a borrower in default, whether or not he or she is a protected borrower, the lender should be required to serve the borrower with a notice of default in prescribed form, together with a statement of account showing the amount outstanding on the loan and the payment required to put the security agreement in good standing, as of the date the lender intends to commence further proceedings to enforce the security agreement.

68. The notice of default and statement of account should be served not less than ten business days after default has first occurred under the security agreement.

69. The notice of default should be in writing and should set out, in plain language (see Recommendation 73), the default or defaults under the security agreement, the rights and remedies of the lender and the borrower on default, and such other information as may be prescribed.

70. (1) For the purpose of subjecting lenders to the disclosure requirements, and subject to the exceptions proposed in paragraph (2), the term "lender" should be broadly defined to include, for example, any person who lends money on the security of land and any person who acts for either the borrower or the lender in arranging a loan on the security of land. The disclosure requirements should be imposed on such persons as real estate agents or solicitors if they are performing a function similar to that of a mortgage broker, but not if they are merely facilitating the loan transaction by preparing the relevant documentation.

(2) An exemption from the disclosure requirements at the advertising or first inquiry stage and at the commitment stage should be created with respect to:

(a) a vendor take-back security agreement, where the vendor would be a protected borrower if he or she sought financing on the security of the land purchased;

(b) a security agreement involving a related lender; and

(c) an agreement that secures a loan, in an amount prescribed by regulation, by a non-professional lender who, each year, makes no more than two loans secured by an interest in land.

71. A lender who wilfully fails to make disclosure at the advertising or first inquiry stage should be guilty of an offence and subject to a fine of not more than $2,000.

72. (1) Where, at the commitment stage, there is a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the disclosure requirements, the validity of the security agreement, or any proceeding taken to enforce it, should not be affected. In such a case, however, the court should have the power to award compensatory damages to the borrower.

(2) Where the lender fails to comply with the disclosure requirements at the commitment stage:

(a) in addition to the lender's potential liability in damages, at the time that such failure is discovered, the protected borrower should be entitled to exercise the right of prepayment, without payment of any compensation to the lender; and

(b) the borrower should be required to exercise the right of prepayment within sixty days of the time that he or she first becomes aware of the lender's non-compliance.

(3) Where there is a conflict between the terms of the disclosure statement and the security agreement, or a failure to comply with the proposed disclosure requirements at the commitment stage, the lender should be guilty of an offence punishable by a fine of not more than $2,000.

73. (1) All disclosure statements given to a protected borrower, as well as the security agreement itself, should be subject to a "plain language" requirement. That is, every security agreement and every disclosure statement provided to a protected borrower should be written in a clear and coherent manner, using words with common and everyday meanings. The clauses should be

appropriately divided and captioned. Where the security agreement uses personal pronouns in referring to the lender or borrower, the second person pronoun should be used in referring to the borrower. Finally, the security agreement and disclosure statement should be written in type of easily readable size.

(2) The lender should be liable to a fine of not more than $2,000 for breach of the plain language requirements, but such a breach should not have any effect on the validity or enforceability of the security agreement.

74. Regulations under the proposed *Land Security Act* should not, at this time, provide short form, plain language covenants that would operate to incorporate by reference more precise and detailed long form covenants. Rather, with respect to terms other than the prescribed mandatory terms proposed in Recommendation 66, lenders should be left to develop the terms that would satisfy their plain language obligations, as well as protect their interests respecting both residential and non-residential security agreements. However, the desirability of a scheme similar to that of the *Short Forms of Mortgages Act* should be reviewed by the proposed Land Security Committee (see chapter 11, Recommendation 161), after the Act has been in force for five years.

CHAPTER 8: REALIZATION OF THE SECURITY: POWER OF SALE AND FORECLOSURE

75. The primary remedy for realization of a lender's security should be a modified extra-judicial power of sale.

76. The remedy of judicial sale should be abolished and the lender's right to take the property in satisfaction of the debt, that is, to exercise foreclosure, should be limited to those circumstances proposed in Recommendations 97-105.

77. (1) At any time before the commencement of sale proceedings, the borrower should be entitled to reinstate the agreement, either by paying the arrears that are due or by performing any covenant that is in default.

(2) For the purpose of reinstatement, arrears should include:

(a) all amounts that are payable to the lender at the time of payment, but not the accelerated amount that may be triggered by the default itself; and

(b) any amounts payable by the lender for the reasonable protection of the lender's security, such as taxes, insurance premiums, condominium maintenance fees, and the costs of commercially reasonable repairs, regardless of whether the lender has actually made such payments.

78. The borrower should be afforded a minimum of ten business days, from service of the notice of default, within which to remedy the default, after which the lender should be entitled to commence sale proceedings.

79. If the borrower fails to remedy the default within the proposed ten day minimum period, the lender should be entitled to serve on the borrower a notice of sale, together with a statement of account.

80. The form of the notice of sale should be prescribed by regulation and should specify the date after which the lender intends to take steps to sell the property.

81. The notice of sale and the statement of account should be served on the following persons, other than persons whose interests in the secured property are prior to the interest of the lender:

    (a) where the property is registered under the *Land Titles Act*, every person appearing by the register of title and by the index of executions to have an interest in the property;

    (b) where the property is registered under the *Registry Act*, every person appearing by the abstract index and by the index of writs received for execution by the sheriff of the county or district in which the property is situate to have an interest in the property;

    (c) where there is a statutory lien against the property in favour of the Crown or any other public authority and the lender has written notice of the lien, the Crown exercising the power of sale or other public authority claiming the lien;

    (d) where the lender has actual notice of any other interest in the property and where such notice has been received prior to the giving of the notice of sale, the person having such interest;

    (e) where the property is a matrimonial home within the meaning of Part II of the *Family Law Act, 1986*, the spouse of the borrower unless:

        (i) the spouse has released all rights under Part II of the Act by a separation agreement;

        (ii) a court order has been made releasing the property as a matrimonial home; or

        (iii) the property ceases to be designated as a matrimonial home pursuant to the provisions of the Act; and

    (f) the guarantor of the borrower.

82. There should be a period of delay prior to the exercise of the proposed extra-judicial power of sale. The borrower should have a total of four months after default and not less than two months after service of the notice of sale (which period should include the delays proposed in chapter 7, Recommendation 68, and in this chapter, Recommendation 78), in order to reinstate the security agreement, refinance the debt, or sell the property.

83. (1) During the delay period proposed in the preceding recommendation, the lender should be expressly prohibited from taking any steps relating to the exercise of the power of sale, including advertising or listing the property for sale, negotiating a sale, or selling the property.

(2) The recommendation in paragraph (1) should not affect the lender's right to possession of the property during this period (see chapter 10).

84. The proposed delay period should be uniform for all borrowers and lenders.

85. (1) The delay period prior to the exercise of the extra-judicial power of sale should not be subject to abridgement or exclusion by agreement between the parties at any time prior to service of the notice of sale, but the parties should be free to agree in writing to abridge or exclude the delay period after that time.

(2) The lender and subsequent encumbrancer should be entitled to apply to the court at any time, without notice to the borrower, for leave to sell the secured property immediately.

(3) Having regard to all the circumstances, the court should be empowered to grant leave to exercise the power of sale without notice, or with notice to such persons, in such manner, and within such time as the court considers proper.

(4) The court order referred to in paragraph (3) should be conclusive of the matters determined in the order.

86. The proposed delay period should be fixed and there should be no discretionary power in the court to extend it, except with the consent of the parties.

87. Despite any rule of law or equity, the court should not be entitled to restrain temporarily or permanently the lender's proper exercise of the power of sale, except with the consent of the parties.

88. (1) The standard of care required of a lender in the conduct of a sale should be that of commercially reasonable care, requiring the lender to obtain the highest realizable price possible under existing

market conditions, taking account of the fact that the property is being disposed of at a forced sale. This standard should be imposed by statute.

(2) The lender should be entitled to sell the secured property by tender, public sale, private sale, by one or more contracts, as a unit or in parcels, at any time of day and place and on any terms, including sale on credit, but, subject to paragraph (3), every aspect of the sale, including advertising, time of day, place, and terms should be commercially reasonable, having regard to the nature of the secured property and the circumstances of the sale.

(3) In determining whether a sale is reasonable, the exact timing of the sale should not be considered a factor.

89. The lender's duty of care should be owed to all persons who, in the reasonable contemplation of the lender, are likely to be injured by a breach of that duty.

90. (1) The limitation period for an action alleging a breach of the lender's duty of care in the sale of the property should be two years from the date on which the interest of the borrower in the secured property is terminated.

(2) However, the proposed limitation period should not affect the right of any person to raise, at any time, the lender's breach of the duty of care as a defence to an action on the covenant where there is a deficiency (see chapter 9).

91. There should be no change to the existing rule that the onus of establishing a breach of the duty of care rests on the party alleging it.

92. (1) The proposed standard of commercially reasonable care should not be capable of limitation or waiver by any borrower.

(2) However, the parties to a commercial security agreement should be free to define in advance the type of conduct that would satisfy the requisite standard of care in the conduct of a sale, but the agreement between the borrower and lender should not preclude a court from determining the issue whether the lender has, in fact, met the standard of commercial reasonableness.

93. (1) Where a sale is conducted by the lender's agent:

(a) the sale should be carried out in a commercially reasonable manner;

(b) the agent's duty of care should be owed to all persons who, in the reasonable contemplation of the agent, are likely to be injured by a breach of that duty; and

(c) the lender and agent should continue to be jointly and severally liable for any loss or damage caused by the agent's failure to meet the standard of commercially reasonable care.

(2) Where the use of an agent is commercially reasonable, the costs associated with such use should be recoverable by the lender.

(3) However, where an agent is not used, the lender should not be entitled to remuneration for his or her own care and trouble in the sale of the property.

94. The lender should not be entitled to seek directions from the court concerning whether any steps proposed by the lender in the sale of the property meet the standard of commercial reasonableness.

95. (1) Upon sale of the property to a purchaser in good faith and for value, the interest of the lender, borrower, and all persons with a subordinate interest in the secured property should be extinguished.

(2) For the purpose of the extinguishment of such interests, a sale should be considered to have taken place where the lender has accepted a written offer to purchase the property.

(3) Where the sale of the secured property is not completed, all interests that were extinguished upon the acceptance of the written offer should be revived, and the interests should rank in terms of their priorities as at the time of the sale. In addition, the borrower's entitlement to relief from acceleration should be revived.

(4) Where the sale is not completed, the lender should immediately advise the borrower and serve a written notice on any person who was entitled to receive the original notice of sale (see Recommendation 81) that his or her interest has been revived. If the service of the notice of sale has been waived by the court with respect to any person (see Recommendation 85(3)), that person should not be entitled to be served with the subsequent notice that his or her interest in the property has been revived.

96. (1) A borrower should be entitled to relief from the consequences of his or her default at any time between the date of service of the notice of sale and the date on which the borrower's interest is extinguished by the sale or by foreclosure, provided that the borrower pays the arrears due, performs any other covenant breached, pays the amount of any payment made by the lender where the lender has performed a covenant on behalf of the borrower by making a payment to a third party, and reimburses the lender for the costs and expenses that have been reasonably incurred by the lender in exercising his or her rights. This right

should not be capable of abridgement or waiver by agreement between the parties.

(2) The right to relief from acceleration following service of a notice of sale should be available only once in every twelve month period, except where the lender otherwise agrees, but this limitation on the availability of relief should not apply with respect to protected borrowers.

97. The remedy of foreclosure should be retained, but modified by the recommendations that follow.

98. (1) Where, after a notice of sale has been served on a borrower, and during the delay period prior to the exercise of the proposed extra-judicial power of sale, it appears that the proceeds of a sale of the secured property would not exceed the lender's debt, the lender should be entitled to send a notice requesting consent to foreclosure.

(2) The notice requesting consent to foreclosure should be in a prescribed form and should be served on the borrower and subsequent encumbrancers.

(3) The lender should include with the notice copies of all appraisals of the property that are in the lender's control or possession and, where the borrower is a protected borrower, should provide the borrower with a statement, in plain language, specifically describing the consequences of consenting or refraining to consent to foreclosure.

99. (1) Upon service of the notice requesting consent to foreclosure, the borrower or a subsequent encumbrancer should be entitled either to consent or refuse to consent to foreclosure.

(2) Consent to foreclosure should be given in a prescribed form, which should accompany the lender's notice requesting consent.

(3) Consent given by a borrower or subsequent encumbrancer should not be capable of being withdrawn.

100. The borrower or a subsequent encumbrancer should be entitled to refuse to consent to foreclosure by serving a written objection on the lender.

101. During the four month delay period, the borrower or subsequent encumbrancer should be entitled to refuse consent on any ground; after the delay period, it should be possible to refuse consent only where there are reasonable grounds to believe that the proceeds of a sale of the property will exceed the amount owing to the lender who seeks consent.

102. (1) After the proposed delay period, the lender should be entitled to serve on the borrower and subsequent encumbrancers the same type of notice requesting consent to foreclosure as that referred to in Recommendation 98.

(2) The post-notice procedure proposed above should apply, except that, if the borrower and subsequent encumbrancers do not serve a written objection on the lender within twenty business days of the date on which service of the notice is effective, the borrower and subsequent encumbrancers should be deemed to have consented to the foreclosure.

(3) Where the borrower or the subsequent encumbrancer did not receive the lender's notice, and where the lack of notice caused prejudice to him or her, the court should be empowered to set aside the consequences of the person's failure to respond, on such terms as are just.

103. Where a lender is unable to sell the secured property for an amount that will satisfy the borrower's indebtedness to the lender within three months of the last day of the delay period, or where consent to foreclosure has been refused after the expiry of the delay period and the lender would be unable to sell the secured property for such an amount, the lender should be entitled to apply to the court for an order for foreclosure, that is, to take the property in full satisfaction of the debt.

104. Notice of the application for foreclosure should be served on the borrower and all other persons entitled to the notice of sale at least ten business days before the application is scheduled to be heard.

105. (1) In the case of either foreclosure by consent or judicial foreclosure, a certificate of foreclosure should be completed in a form prescribed by regulation.

(2) Upon registration of the certificate of foreclosure in the appropriate land registry office, all subsequent interests in the land, including that of the borrower, should be extinguished. The lender should become the absolute owner of the property and should no longer be accountable to the borrower with respect to the property. The borrower should have no right to reopen the foreclosure on any grounds other than the lender's fraud in obtaining the certificate, and the borrower's liability to the foreclosing lender should be discharged.

CHAPTER 9: THE ACTION ON THE COVENANT

106. Subject to the recommendations concerning the liability of a protected borrower who transfers the property to a purchaser who assumes the security agreement, a lender should be entitled to exercise the basic

contractual right to proceed on the borrower's personal covenant for payment of the debt, at any time after the notice of sale has been served on the borrower in default (see chapter 8, Recommendation 79).

107. Where the lender wishes both to sell the property and to sue the borrower on the covenant, the lender should not be entitled to commence the action on the covenant until a notice of sale has been served on the borrower. Where the lender wishes simply to proceed on the covenant, the lender should be required to serve a notice of default and the statement of claim should not be served until the expiry of ten business days from service of the notice of default.

108. The proposed *Land Security Act* should include provisions analogous to sections 19 and 20 of the *Mortgages Act*. However, the provision analogous to section 19 should be modified to provide that the lender is entitled not only to sue the original borrower and the purchaser, but also to recover judgment against both of them on the basis of joint and several liability.

109. (1) There should be a statutory implied right of indemnification of the borrower or transferor of the property by the transferee, subject to an express agreement to the contrary.

(2) Subject to an express agreement to the contrary, the statutory implied right of indemnification should not arise merely upon transfer of the property to a subsequent lender by way of a quit claim from the owner of the property.

110. Where the transaction involves a protected borrower, the original borrower should be relieved of all liability on the personal covenant in the security agreement if the property is transferred to a person who has been approved, or ought reasonably to have been approved, by the lender.

111. (1) Where the lender approves the purchaser, not only the original borrower, but also his or her guarantors, should be relieved of any further liability on those covenants of the security agreement that are assumed by the purchaser.

(2) Unless a contrary intention is expressed to the lender, the purchaser should be presumed to have assumed liability for all of the borrower's personal covenants in the security agreement, such as the covenant to insure and to repair, and not merely the covenant to pay the debt.

(3) However, the borrower and purchaser should remain free to agree that the purchaser is assuming only certain specified covenants, as a result of which the borrower would remain liable for those covenants that have not been assumed. Upon a request to the

lender for approval, the lender should be advised of this partial assumption of liability.

(4) A purchaser who has been approved by the lender should remain liable to the lender, to the extent proposed above, until there has been a subsequent transfer of the property, at which time the preceding recommendations concerning the liability of the parties to a sale of the property should apply.

112. In all cases, a protected borrower should be relieved of all liability on his or her personal covenant in the security agreement unless the lender demands from the borrower or his or her guarantor payment of the outstanding amount owing to the lender within six months after maturity of the security agreement, whether or not the borrower had sought approval of the transfer at the outset.

113. In order to obtain relief from liability on a transfer of the secured property by a protected borrower, the protected borrower should be required to request that the lender approve the assumption of the security agreement by the purchaser. The request should be in a form prescribed by regulation and should be served on the lender.

114. The lender should be required either to give written approval of the purchaser or to advise the borrower in writing that approval is being withheld, and the reasons for such non-approval.

115. In determining the suitability of the purchaser, the lender should be permitted to make the same kind of inquiry as would reasonably be made in an application for a new secured loan by a protected borrower. More specifically, the lender should be entitled to withhold approval of a purchaser if, on commercially reasonable grounds, the substitution of the purchaser for the original borrower would materially increase the lender's risk under the security agreement.

116. The costs of making a reasonable inquiry into the suitability of the purchaser should be paid to the lender by either the original borrower or the purchaser, as they determine between themselves.

117. The lender's approval or refusal of the purchaser of the secured property should be required to be given to the borrower within ten business days of receipt by the lender of all the information reasonably required for determining the suitability of the purchaser.

118. Where a lender reasonably withholds approval of a purchaser, or where the original borrower has not sought the lender's approval, the borrower should remain liable on the personal covenants of the security agreement, subject to Recommendation 112.

119. (1) Where the lender unreasonably withholds approval, the borrower or the purchaser should be entitled to apply to the court to obtain approval of the purchaser and to relieve the borrower from liability under the security agreement. The burden on the borrower or the purchaser in such an application should be similar to that of a lessee in the case of an attempted assignment of a residential lease, where the lease provides that consent to an assignment must be obtained but that such consent is not to be unreasonably withheld.

(2) Where the lender unreasonably withholds approval, and where the borrower or the purchaser does not wish to apply to the court, as recommended in paragraph (1), the lender's unreasonable refusal to approve the purchaser should constitute a defence to any subsequent action against the borrower on his or her personal covenant in the security agreement.

120. Where the lender fails to respond to the protected borrower's request for approval of the purchaser in a timely fashion (see Recommendation 117), the lender should be deemed to have consented to the assumption of the security agreement by the purchaser.

121. A tariff should be established by regulation to govern the costs of inquiring into the suitability of the purchaser, and the tariff should be subject to revision on a regular basis. If, in a particular instance, the borrower disputes any unusual or extra costs that the lender maintains had to be incurred in making the necessary inquiries, either party should be entitled to apply to the court to have the reasonableness of such costs determined.

CHAPTER 10: POSSESSION OF SECURED PROPERTY

122. (1) A borrower who is not a protected borrower should be entitled to retain possession of the secured property until there has been a default under the security agreement. Upon default, the lender should be entitled to take possession of the secured property.

(2) In transactions that do not involve protected borrowers, the parties should be entitled to contract out of the general rule proposed in paragraph (1) and to establish, either before or after default, their own rules governing rights to possession of the secured property.

123. (1) Where the borrower is a protected borrower, the lender should not be entitled to take possession of the secured property until the proposed minimum four month delay period has expired, subject to the exceptions proposed in Recommendations 124(2), 125, and 126.

(2) The lender should be required to obtain a writ of possession and should be entitled to the writ at any time after default, but the writ should not be effective until the expiry of the four month delay period.

(3) The protected borrower should be advised in the notice of default of the right to remain in possession during the delay period.

124. (1) Any term of the security agreement, or any collateral agreement entered into, that purports to waive or limit a protected borrower's right to possession until expiration of the proposed delay period should be void and unenforceable.

(2) However, a protected borrower should be entitled to consent to possession by the lender, provided that such consent is in writing and has not been sought or given until after service of the notice of sale on the borrower.

125. (1) A lender should be entitled at any time to apply to the court for leave to issue a writ of possession without notice to the borrower.

(2) Among the circumstances that should be considered by the court in such an application should be the abandonment or apparent abandonment of the secured property by the borrower and the commission, or the failure to prevent the occurrence, of waste of the secured property.

(3) The court should be empowered, having regard to the circumstances, to grant leave to issue the writ of possession without notice or with such notice to such persons, in such manner, and within such time as the court considers proper.

126. (1) Prior to the expiry of the proposed delay period, the lender should be entitled to take possession of property that has been or appears to have been abandoned, without obtaining a writ of possession.

(2) The lender should be entitled to presume that the property has been abandoned where all reasonably available evidence, including the condition of the property, would lead a reasonable person to believe that the borrower has vacated the property and does not intend to return.

(3) The lender should be required to make reasonable inquiries in order to obtain such evidence and, more particularly, to determine whether the borrower's absence is of a temporary or permanent nature.

127. A notice of the lender's intention to take possession of the property should be served on the borrower. The lender should also be required to post a notice on the property, stating that the lender intends to take

possession, in order that a returning borrower may be made aware of any proceedings that have taken place in his or her absence.

128. If the borrower did not intend to abandon the property, he or she should be entitled to retake possession immediately.

129. A lender who has taken possession without reasonable belief that the property has been abandoned, or without having complied with the procedural safeguards proposed above, should be liable for any actual damage suffered by the borrower. Where, however, the lender has acted reasonably in assuming the property was abandoned, the lender should not be liable to the borrower, notwithstanding that the lender was in error in taking possession.

130. Where the lender takes possession of the secured property and finds chattels on that property, the lender should be required to conduct such searches as may be appropriate in the circumstances against the name of the borrower, of motor vehicles for which permits have been issued under the *Highway Traffic Act*, and of the individual debtor index, business debtor index, or motor vehicle index established under the *Personal Property Security Act*.

131. (1) Where it appears to the lender, from a search or otherwise, that a person has or may have an interest in any of the abandoned chattels, the lender should be required to give notice in writing to such person that the lender has taken possession of the chattels.

(2) Such a person should be required to make a claim to the chattels within fifteen business days after notice in writing has been received.

132. Where a person makes a claim to an interest in the abandoned chattels, either as a result of, or independently of, the lender's notice, and the lender believes on reasonable grounds that that person's claim is valid, the lender should be required to permit such person to take possession of the chattels. Where the lender does so, the lender should incur no liability to the borrower, the true owner of the chattels, or any person having interest in the chattels.

133. The lender or a claimant should be entitled to apply to the court in order to determine the validity of any claim made to an interest in chattels abandoned on the secured property.

134. (1) Where the lender believes, on reasonable grounds, that no person other than the borrower has an interest in any of the abandoned chattels, or where a person who has received the lender's notice does not respond to the notice within fifteen business days after receipt, the lender should be entitled to sell or otherwise dispose of the chattels by any commercially reasonable method, without

liability to the borrower, the true owner of the chattels, or any other person having an interest in the chattels.

(2) Where, in accordance with paragraph (1), the lender disposes of abandoned chattels that are subject to a personal property security interest or owned by a person other than the borrower, to a person who acquires them in good faith, the rights of the secured party or true owner in respect of the property or any proceeds thereof should be extinguished. The lender should be able to sell the chattels free of such rights.

135. Where a third party's rights in the chattels have been extinguished, the lender should be required to account to the third party up to the amount of the proceeds of sale, or the value of the chattels if the lender has kept them, after deducting the reasonable expenses incurred in selling the chattels or otherwise lawfully dealing with them.

136. Where the lender disposes of chattels by sale, the proceeds of disposition should be applied first to pay the lender's reasonable expenses of disposing of the chattels, including the costs of processing or preparing the chattels for sale. The balance of the sale proceeds should be distributed as part of the proceeds of the sale of the secured property.

137. There should be no jurisdiction in the court to postpone the lender's right of possession, or to adjourn any proceedings instituted in respect of that right, beyond the proposed four month delay period.

138. (1) The standard of care for a lender or a lender's agent in the custody and preservation of secured property in the lender's possession should be that of commercially reasonable care, having regard to the nature of the secured property. Accordingly, the lender or the lender's agent would be required to do whatever was usual or customary in order to maintain the value, usefulness, and condition of the property, having regard to the interests of the borrower, subsequent encumbrancers, and others who may be affected by a breach of the proposed standard, and to the nature and condition of the property.

(2) The proposed statutory formulation of the standard of care for a lender or a lender's agent should not specify particular duties that would satisfy the standard.

(3) The costs of such custody and preservation should be borne by the borrower and, therefore, added to the debt.

(4) There should be no change to the existing rule that a lender is liable for the acts of the agent, pursuant to the common law principles of agency.

139. The borrower or any person having an interest in the property should continue to be entitled to apply to the court to enjoin a lender or a lender's agent whose actual or expected standard of conduct in the care of the property fails, or will fail, to meet the proposed standard.

140. If the lender or the lender's agent fails to comply with the proposed standard of care, the lender and the lender's agent should be jointly and severally liable for any loss or damage caused to any person, including the borrower, subsequent encumbrancers, and guarantors, who, in the reasonable contemplation of the lender or the lender's agent, might suffer such loss or damage.

141. If a borrower is held liable for wrongdoing for which the lender in possession is responsible, the borrower should be entitled to indemnification by the lender.

142. (1) The proposed standard of commercially reasonable care to be exercised by a lender in possession should not be capable of being waived or limited by the borrower, whether or not a protected borrower.

(2) However, the parties to a transaction that does not involve a protected borrower should be entitled to define, in advance, the conduct required of a lender in possession in order to satisfy the standard of commercial reasonableness.

(3) Upon the application of any person who is affected by the issue whether the standard of commercial reasonableness has been satisfied, the court should be empowered to determine the issue, notwithstanding that such conduct conforms to the terms agreed upon by the borrower and the lender.

143. (1) The lender should be entitled to recover moneys spent in the repair of the property, provided that the expenditure is commercially reasonable in the circumstances.

(2) The borrower, the lender, or any interested person should be entitled to apply to the court for a determination whether a proposed expenditure or an expenditure already incurred is or was commercially reasonable and, therefore, recoverable by the lender.

144. (1) The lender should be entitled to claim, as part of the expenses of possession, reasonable compensation for his or her own care and trouble in fulfilling necessary duties in the management of the secured property.

(2) The parties should be free to agree in advance regarding what constitutes reasonable compensation for the lender's services. However, the lender should be entitled to no greater compensation than is reasonable in the circumstances.

(3) The agreed amount should be subject to challenge in court by any interested person.

145. (1) There should be no change to the existing law that allows a lender to recover the costs of employing an agent where it was commercially reasonable to do so.

(2) However, the reasonableness of the costs of an agent should be capable of being challenged in court by any interested person.

146. (1) Where a borrower is in default, the lender should be entitled to serve a tenant of the borrower with a notice, in prescribed form, demanding rent.

(2) The notice should set out, in plain language, the reason for the notice, the rights and remedies of the lender, the borrower, and the tenant in respect of the notice, and such other information as may be prescribed.

147. (1) Once the tenant receives the notice from the lender, the tenant should be required to make all payments of rent in the manner prescribed by the notice, until directed otherwise by the lender or the court.

(2) A tenant who, in good faith, makes the payments under these circumstances should be relieved from liability to the borrower.

(3) Where the tenant fails, without reasonable excuse, to make such payments, the tenant should be liable to the lender for the rent, including any rent paid to the borrower while the notice demanding rent was in force.

148. (1) Where the tenant receives notice from more than one lender, the tenant should be required to comply with the notice from the lender having the prior interest in the secured property.

(2) Where the tenant, faced with conflicting claims to rent, is uncertain as to a lender's right to the rent, the tenant should be entitled to apply to the court for directions.

(3) Where the tenant brings such application, the tenant should be entitled to his or her solicitor and client costs, to be fixed by the court at the time of the application.

(4) The costs should be set off against the rent that the tenant is obliged to pay, unless the court orders otherwise.

149. The lender should be required to serve on the borrower a copy of the proposed notice to the tenant to pay rent at the same time that the tenant is served.

150. (1) Where a dispute arises between the borrower and the lender as to the right to obtain rent, either party should be entitled to make an application to the court to resolve the issue.

(2) The notice to the borrower should expressly advise him or her that any dispute regarding the lender's claim may be resolved by application to the court.

151. Where a lease binds the lender:

(a) the lender's entitlement to rent should include entitlement to payment of any arrears of rent; and

(b) the definition of "landlord" in the *Landlord and Tenant Act* should be amended to provide that that term shall include a lender in possession of property subject to a binding lease, whether that property is commercial or residential premises.

152. (1) Where a lender takes possession of property that is subject to a non-binding commercial lease, the lender should be entitled either to evict the tenant, to enter into a new binding tenancy agreement, or to demand and receive payment of rent from the tenant.

(2) The lender's demand for, and receipt of, rent should not necessarily give rise to the inference that the lender has assumed the obligations of a landlord.

153. (1) Where a lender takes possession of residential premises, as defined in the *Landlord and Tenant Act*, that are subject to a non-binding lease that satisfies the requirements proposed in paragraph (2), the terms of the lease should bind the lender for the period of its unexpired term, but not less than 120 days and not more than one year from the date the lender takes possession of the property.

(2) The preceding proposal should apply only to a non-binding lease of residential premises that meets the following minimum requirements:

(a) the rent provided by the lease between the borrower and the tenant should be commercially reasonable for the premises in question; the time for determining the reasonableness of the rent should be the time at which the lease was entered into, not the date at which the lender takes possession;

(b) the lease must provide for payment of rent no more than three months in advance; and

(c) the tenant must be required to take possession of the premises not more than six months after the date of the lease, or, where the premises are under construction, upon completion of the construction.

(3) Any dispute with respect to whether a lease meets the requirements described in paragraph (2) should be resolved by the court on the application of the lender or the tenant.

154. Where a lender takes possession of residential premises under the circumstances described in the preceding recommendation, the lender:

(a) should be required immediately to give written notice that he or she has taken possession and has become the landlord, and setting out the date on which the lender is entitled to obtain vacant possession of the secured property; and

(b) should have all the rights and be subject to all the obligations of a landlord, and in order to resolve any uncertainty, Part IV of the *Landlord and Tenant Act* should be made to apply to such a tenancy, except that, notwithstanding the provisions of Part IV respecting the termination of a tenancy, the lender should be entitled to a writ of possession upon expiration of the period proposed in Recommendation 153(1).

155. Where a non-binding lease of residential premises does not meet the minimum requirements proposed in Recommendation 153(2), the rights of the lender *vis-à-vis* the tenant and the borrower should be the same as those recommended for a lender in possession of property subject to a non-binding commercial lease (see Recommendation 152).

156. (1) With respect to a commercial lease and a residential lease that does not meet the minimum requirements proposed in Recommendation 153(2), a lender who intends to evict the tenant should be under a duty to send to the tenant a notice to quit, in prescribed form, specifying the date on which the lender requires vacant possession, not earlier than ten days from the receipt of the notice.

(2) If the tenant refuses to give vacant possession, the lender should be entitled to apply for a writ of possession.

(3) The application for a writ of possession should not be capable of being stayed or adjourned on the ground of hardship.

157. (1) A lender's right to distrain with respect to property of a protected borrower should be abolished.

(2) Provisions analogous to sections 13, 14, and 15 of the *Mortgages Act* should continue to govern a lender's right to distrain where the borrower is not a protected borrower.

CHAPTER 11: MISCELLANEOUS MATTERS

158. (1) Unless and until it is shown that the application procedure under the Rules of Civil Procedure is unequal to the task of providing an expeditious, effective, and inexpensive means of resolving disputes in the context of land security arrangements, that procedure, as modified by paragraph (2), should continue to be used to deal with all issues recommended to be dealt with by application to the court.

(2) Applications pursuant to the proposed *Land Security Act* should be heard not only by a judge or local judge of the Supreme Court of Ontario, as is now the case under the Rules of Civil Procedure, but also by a master of the Supreme Court.

(3) The legislative mechanism empowering a master to hear such applications should be designed to meet any constitutional objections raised by section 96 of the *Constitution Act, 1867*.

159. (1) Documents should be served either personally, in the manner provided by the Rules of Civil Procedure, or by mail.

(2) In connection with service by mail:

(a) documents to be served on the lender should be sent by registered mail to the lender's designated address for service set out in the security agreement or, if the borrower knows that the designated address is no longer valid, to the branch or other office of the lender where the borrower normally makes payment or to such other address of the lender known to the sender;

(b) documents to be served on the borrower should be sent by both registered and prepaid first class mail to the borrower's designated address for service set out in the security agreement, or to the borrower's last known address, if the sender knows that the designated address is no longer valid, or to the secured property, if the sender knows that the first two addresses are no longer valid; and

(c) documents to be served by mail on a person other than a lender or a borrower should be sent both by registered and by prepaid first class mail to the person's designated address or, if the sender knows the designated address is no longer valid, to a branch or other office of the person or to such other address of the person known to the sender.

160. (1) The court should fix the costs of an application brought under the *Land Security Act* at the time of the hearing, unless in the circumstances it would be inappropriate to do so.

(2) Where an application is brought because of a lender's failure, without reasonable excuse, to comply with his or her statutory obligations respecting the provision of a statement of account or a discharge, prepayment of the loan, or the assumption of the security agreement, the court should award costs of the application to the applicant on a solicitor and client basis, to be paid forthwith.

(3) The court should be empowered to order that the costs be added to, or subtracted from, the amount due under the security agreement.

161. (1) A permanent specialized ministerial committee, dealing exclusively with matters relating to land security, should be established.

(2) The committee should meet on a regular basis, and more frequently in the early years after implementation of the Commission's reform proposals, in order to monitor, and to make recommendations concerning, the law and practice pertaining to land security transactions.

(3) The committee should be constituted in time to review drafts of the proposed new *Land Security Act* before its enactment. In addition, the committee should be involved in reviewing the various forms recommended to be prescribed under the proposed Act and in preparing the "information booklet" of questions that should be made available to prospective borrowers to enable them to determine both where they will obtain financing and the desirability of particular offers to finance.

(4) The committee should be composed of experts broadly representative of the community affected by land security law and practice, as well as government officials representing ministries whose supervisory responsibilities relate to matters pertaining to land security transactions.

162. (1) The disclosure requirements should not apply where the security agreement was registered before the date on which the proposed *Land Security Act* comes into force.

(2) Lenders should be required to comply with disclosure obligations that arise only after the date that the proposed Act comes into force.

(3) Subject to paragraphs (1) and (2), the *Land Security Act* should apply to all land security agreements in existence on the date on which the legislation comes into force.

CONCLUSION

In this Report, we have examined the law relating to land security transactions with a view to rationalizing and centralizing that law, effecting a proper balance between the rights of lenders and borrowers, and addressing specific aspects of mortgage law that were perceived to be anachronistic or otherwise in need of reform. We have been ably assisted in this task by many persons, to whom reference has been made in chapter 1 of this Report. Once again, the Commission wishes to express its appreciation for their contribution.

All of which is respectfully submitted.

James R. Breithaupt
Chairman

H. Allan Leal
Vice Chairman

Earl A. Cherniak
Commissioner

J. Robert S. Prichard
Commissioner

Margaret A. Ross
Commissioner

March 31, 1987

APPENDIX 1

Draft Bill
being a Bill introducing the *Land Security Act*

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BILL 00

An Act to replace the *Mortgages Act*

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of Ontario, enacts as follows:

PART I

GENERAL

1.1 In this Act,

1. "borrower" means a person who owes payment or other performance of the obligation secured, the person's spouse and the person's successors, and includes a chargor and a mortgagor, but, unless otherwise provided, does not include a guarantor.

2. "business day" means a day other than Saturday, Sunday or a holiday.

3. "conveyance" includes assignment, appointment, lease, settlement and other assurance and covenant to surrender made by deed on a sale, demise or settlement of any land or on any other dealing with or for any land; and "convey" has a corresponding meaning.

4. "court" means the Supreme Court of Ontario or the District Court of Ontario.

5. "Crown" means Her Majesty in right of Ontario, and Her Majesty in right of Canada.

6. "Director" means the Director of Land Registration appointed under subsection 6(1) of the *Registry Act*.

7. "discharge" means a discharge of a security interest and includes a cessation of charge under the *Land Titles Act* and a certificate of discharge of mortgage under the *Registry Act*.

8. "encumbrance" includes a security agreement, a trust for securing money, a lien, and a charge of a portion, annuity or other capital or annual sum; and "encumbrancer" has a corresponding meaning, and includes every person entitled to the benefit of an encumbrance, or to require payment or discharge thereof.

9. "guarantor" includes an individual or the spouse of an individual who undertakes responsibility for the performance of an obligation in a security agreement by the borrower.

10. "land" means land and premises, tenements, hereditaments and appurtenances and any estate or interest therein including a leasehold interest.

11. "lender" means a person in whose favour there is a security interest, and the person's successors.

12. "prescribed" means prescribed by the regulations.

13. "protected borrower" means an individual who is a borrower or guarantor and,

    (a) resides in the secured property where it is a single-family residence or residential unit;

    (b) resides in the secured property where it is a farm and the amount of the security agreement does not exceed the prescribed amount;

    (c) resides in one of the units in the secured property where it is a multi-unit building of not more than five units and the amount of the security agreement does not exceed the prescribed amount;

    (d) resides in part of the secured property where it is a commercial or manufacturing enterprise and the amount of the security agreement does not exceed the prescribed amount; or

    (e) where the amount of the security agreement does not exceed the prescribed amount.

14. "purchase-money security agreement" means a security agreement that is taken or retained by the seller of the secured property to secure all or part of its price; and "purchase-money lender" and "purchase-money borrower" have corresponding meanings.

15. "regulations" means the regulations made under this Act.

16. "residential security agreement" means a security agreement given to a protected borrower.

17. "secured property" means land subject to a security interest.

18. "security agreement" means a writing that creates or provides for a security interest and includes a charge under the *Land Titles Act* and a mortgage and any collateral agreement relating to the security interest other than mortgage insurance, but does not include a rent charge.

19. "security interest" means an interest in land given by a borrower or a guarantor that secures performance of an obligation.

20. "spouse" means "spouse" within the meaning of subsection 1(1) of the *Family Law Act, 1986*.

21. "statement of account" means a statement of account that complies with section 3.15.

22. "successor" includes an executor, administrator, heir and assign.

23. "transfer" means a conveyance of freehold or leasehold land and includes a deed and a transfer under the *Land Titles Act*, but does not include a lease or a security agreement.

PART II

SCOPE AND APPLICATION OF ACT

2.1 The purposes of this Act are to revise, reform, and modernize the law governing security agreements, and to promote fair dealing in transactions leading to security agreements.

2.2 A person having an interest in land may create one or more security interests in the land to the extent of that interest.

2.3 This Act applies to every transaction without regard to its form that is intended to create a security interest in land, including a security agreement, mortgage, charge, debenture, trust deed and any transaction in which an interest in or title to the land is retained by the transferor after the transferee has taken possession of the land, but does not apply to non-consensual liens and similar interests in land.

2.4 The Crown is bound by this Act.

2.5 Except where permitted by this Act, the provisions of this Act shall not be waived or varied and any agreement to the contrary is void.

PART III

RIGHTS AND OBLIGATIONS OF BORROWER AND LENDER

A. *Effect of Security Agreement*

3.1 (1) A security agreement does not operate as a transfer or conveyance of any estate in the secured property to the lender.

(2) Subject to section 3.14 (insurance proceeds) and the terms of the security agreement, any person who damages or injures the secured property is liable to the lender as if the lender were the owner of the secured property, and the lender may require such person to pay the proceeds directly to the lender as compensation.

(3) The liability of a person to the lender under subsection (2) is limited to the amount outstanding under the security agreement at the date that the payment under subsection (2) is made.

(4) Payment by a person under subsection (2) in good faith to the lender is a valid discharge, as between the person and the borrower, to the extent of the payment.

(5) The right of the lender under subsection (2) is subordinate to the right of the borrower.

(6) Where the lender exercises the right given by subsection (2), the lender's expenses and costs shall not,

(a) be added to the amount due under the security agreement; or

(b) be deducted from any proceeds obtained by the lender.

B. *Enforceability of Security Agreement*

3.2 (1) A security interest is not enforceable by or against a borrower unless the borrower has signed a security agreement that contains an adequate description of the land, acknowledges the lender's security interest, and is in registrable form.

(2) Where the security agreement is not in registrable form, but otherwise satisfies the requirements of subsection (1), the court, on the application of the lender, shall compel the borrower to sign a security agreement in registrable form.

(3) Where the security agreement is unenforceable by reason of any defect other than the defect referred to in subsection (2) and where it appears to the court to be just, the court, on the application of the lender, may compel the borrower to sign a security agreement in registrable form.

C. *Copy of Security Agreement*

3.3 (1) On or before the date when the borrower signs the security agreement, the lender shall provide a copy of the security agreement, including standard terms filed with the Director by the lender under section 3.8, to the borrower or the borrower's solicitor.

(2) A lender who contravenes subsection (1) is guilty of an offence and on conviction is liable to a fine of not more than $5,000.

(3) A contravention of subsection (1) does not affect the validity of a security agreement or any proceeding taken to enforce the security agreement, but the court may in the appropriate circumstances award compensatory damages to the borrower.

D. *Terms of Security Agreement*

3.4 (1) Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and against third parties.

(2) No security agreement shall contain terms that derogate from the rights and the remedies of the borrower and the lender under this Act.

(3) Every security agreement shall be deemed to be amended insofar as is necessary to be in conformity with this Act.

(4) A lender who contravenes subsection (2) is guilty of an offence and on conviction is liable to a fine of not more than $5,000.

(5) A contravention of subsection (2) does not affect the validity of a security agreement, or any proceeding taken to enforce the security agreement, but the court may in the appropriate circumstances award compensatory damages to the borrower.

3.5 (1) No term of a security agreement is unenforceable by reason only that it is a clog on the equity of redemption.

(2) Without limiting the generality of subsection (1), no term of any security agreement is unenforceable by reason only that,

(a) the lender is entitled to share in profits earned by the borrower from any enterprise or transaction financed by means of the security agreement; or

(b) the amount due under the security agreement,

  (i) will increase in relation to an increase in the value of the secured property, or

  (ii) will increase in relation to a decrease in the real value of money between the date of the security agreement or an advance under it, and the date of payment of the amount secured by the security agreement.

(3) Subject to subsection (4), an agreement in a residential security agreement that entitles the lender to purchase the secured property is void.

(4) Subsection (3) does not apply where, at the time the security agreement is signed,

(a) the borrower is,

  (i) employed by the lender or a person affiliated with the lender; or

  - (ii) intended to become employed by the lender or a person affiliated with the lender; and

- (b) the terms of the agreement that entitle the lender to purchase the secured property are fair and reasonable having regard to the unusual circumstances of the employment.

3.6 Unless expressly provided to the contrary in a transfer, there is an implied term that the transferee will indemnify the transferor with respect to any security agreement registered on title to the secured property at the date of the transfer.

3.7 (1) A security agreement shall be deemed to include such terms as are prescribed.

(2) Subject to the regulations, a term deemed to be included in a security agreement by subsection (1) may, in a schedule to the security agreement, or in a set of standard terms filed under subsection 3.8(1) and referred to in the security agreement by its filing number, be expressly excluded or may be varied by setting out the term, appropriately amended.

3.8 (1) A person may file with the Director, in the prescribed manner and form, a set of standard terms and, with the consent of the Director, may file a set of standard terms in a form other than the prescribed form.

(2) A set of standard terms filed under subsection (1) may be amended by filing a further set of standard terms under subsection (1).

(3) Where a set of standard terms is filed under subsection (1), the Director shall,

- (a) assign a filing number to the set and advise the person who filed the set of its filing number; and

- (b) ensure that copies of the set, identified by its filing number, are provided to all land registry offices within thirty days of the day on which the set was filed.

(4) Every set of standard terms filed under subsection (1) shall be made available in the prescribed manner and at the prescribed fee for public inspection and copying in all land registry offices on a day not later than thirty days after the day on which the set is filed with the Director.

(5) The Director shall enter all sets of standard terms filed under subsection (1) during each calendar year in a book and shall as soon as possible after the end of the calendar year,

- (a) provide copies of the book to all land registry offices; and

(b) make available copies of the book for purchase by the public at the prescribed fee.

3.9 (1) A security agreement shall be deemed to include a set of standard terms filed under section 3.8 if the set is referred to in the security agreement by its filing number.

(2) A term deemed to be included in a security agreement by subsection (1) may, in a schedule to the security agreement, be expressly excluded or may be varied by setting out the term, appropriately amended.

(3) Where a security agreement refers to more than one set of standard terms by their filing numbers, the security agreement shall be deemed to include only the set that was filed last.

(4) Where there is a conflict between an express term in a security agreement and a term deemed to be included in the security agreement by subsection (1), the express term prevails.

3.10 (1) A security agreement that refers to a set of standard terms filed under section 3.8 by the set's filing number shall not be registered before a copy of the set is available in the land registry office where the security agreement is to be registered, as described in section 3.8.

(2) A contravention of subsection (1) does not affect the validity of the security agreement but the court may in the appropriate circumstances award compensatory damages to the borrower.

3.11 (1) Where the Director is satisfied that a security agreement presented for registration contains terms that should be filed under subsection 3.8(1) because of the frequency of their use in security agreements in favour of the lender, the Director may give the lender notice in the prescribed form and manner that on and after a day specified by the Director, no security agreement in favour of the lender that sets the terms out expressly shall be registered without the Director's authorization.

(2) The day specified by the Director in a notice given under subsection (1) shall be a day at least 120 days after the date of the notice.

(3) Where the Director has given a notice under subsection (1), no security agreement in favour of the lender that sets the terms out expressly shall be registered without the Director's authorization on or after the day specified by the Director.

E. *Priorities*

3.12 (1) In this section, "revolving credit arrangement" means an arrangement,

(a) contained in a security agreement and expressly identified as a revolving credit arrangement; and

(b) under which the borrower may obtain advances from the lender from time to time before or after previous advances have been repaid in whole or in part by the borrower.

(2) Subject to this and any other Act, the priority of registered security agreements is to be determined in accordance with the *Registry Act* or the *Land Titles Act*, as the case may be.

(3) A registered security agreement is a security upon the secured property to the extent of the money or money's-worth actually advanced or supplied under the security agreement not exceeding the amount for which the security agreement is expressed to be a security and any payments made by the lender for the reasonable protection of the lender's security interest including taxes, insurance premiums, condominium maintenance fees, and the costs of commercially reasonable repairs.

(4) A prior registered security agreement has full priority over subsequent registered security agreements up to and including the express amount of the loan, and the amount of any payments made by the lender for the reasonable protection of the lender's security interest, despite the fact that advances under the prior security agreement were made after the registration of the subsequent security agreement, or after the lender under the prior registered security agreement had actual knowledge of the subsequent security agreement.

(5) Except where the security agreement contains a revolving credit arrangement, the priority given by subsections (3) and (4) does not apply to the amount by which the cumulative total of advances made under the security agreement exceeds the amount for which the security agreement is expressed to be a security.

(6) For the purpose of subsection (5), "advances" do not include payments made by the lender for the protection of the security interest referred to in subsection (3).

(7) Where the borrower under a prior registered security agreement is a protected borrower and the security agreement is renewed or extended in accordance with its terms, the renewed security agreement retains its priority over subsequent security agreements to the extent that the terms of the renewed security agreement are set out in the security agreement.

(8) The doctrine of tacking is abolished.

3.13 (1) Where the lender under a prior registered security agreement has not advanced the amount that the security agreement is expressed to secure and the lender refuses to make additional advances to the borrower, the lender's priority may, in accordance with this section, be limited to the amount due under the security agreement at the date of the refusal.

(2) The borrower may register a notice in the prescribed form stating the refusal of the lender to make additional advances under the prior security agreement and setting out the amount due under the prior security agreement at the date of the lender's refusal.

(3) The notice under subsection (2) shall be served on the lender.

(4) The land registrar shall not register the notice under subsection (2) without proof that the borrower has complied with subsection (3).

(5) Where the notice under subsection (2) contains a statement that the borrower knows or ought to know is incorrect, the borrower is liable to any person for any loss or damage caused thereby.

(6) The lender may register a notice in the prescribed form disputing the borrower's notice under subsection (2) as to the refusal of the lender to make additional advances under the security agreement, or as to the amount due under the security agreement at the date of the lender's refusal, as the case may be.

(7) The notice under subsection (6) shall be served on the borrower.

(8) The land registrar shall not register the notice under subsection (6) without proof that the lender has complied with subsection (7).

(9) Where the notice under subsection (6) contains a statement that the lender knows or ought to know is incorrect, the lender is liable to any person for any loss or damage caused thereby.

(10) Where the lender does not register a notice under subsection (6) within ten business days of the date on which a borrower registers a notice under subsection (2), then the borrower's notice shall be deemed to be correct for the purpose of subsection (1).

(11) Where the lender in the notice registered under subsection (6) disputes only the amount due under the security agreement as set out in the notice registered under subsection (2), the lender's notice shall be deemed to be correct for the purpose of subsection (1) until an order under subsection (12) is registered.

(12) Where the lender registers a notice under subsection (6), the court shall, on the application of the borrower or the lender,

(a) determine whether the lender refused to make additional advances under the security agreement;

(b) determine the amount due under the security agreement at the date of the lender's refusal, if any; and

(c) embody its determinations in an order.

(13) The order under subsection (12) may be registered and is conclusive of the matters determined in the order.

F. *Insurance*

3.14 (1) The lender has an insurable interest in the secured property.

(2) A borrower is not obligated to insure the secured property for an amount in excess of the replacement value of the buildings and fixtures.

(3) Unless the security agreement provides to the contrary, all proceeds payable to a borrower on an insurance of the secured property shall, if the lender so requires, be applied by the borrower in repairing or replacing the buildings and fixtures in respect of which the proceeds are received.

(4) Subject to any obligation to the contrary imposed by law or by special contract, a lender may require proceeds payable on an insurance of the secured property to be paid directly to the lender.

(5) Where the security agreement is a residential security agreement the lender shall not require proceeds received on an insurance of the secured property to be paid directly or indirectly to the lender if the borrower intends to repair or replace the buildings and fixtures in respect of which the proceeds are received, but nothing in this section prevents the borrower and the lender from agreeing that such proceeds shall be paid to and held by the lender in trust for the borrower to be disbursed in making such repair or replacement.

(6) A protected borrower may consent to the payment to the lender of proceeds received on an insurance of the secured property if the consent,

(a) is in writing; and

(b) has not been sought or given until after the occurrence of the loss or damage giving rise to the proceeds.

G. *Statements of Account*

3.15 (1) A borrower, or any subsequent encumbrancer who has a right to make payments under section 6.9, may by a notice in writing require the lender to provide a statement of account to the borrower or subsequent encumbrancer.

(2) The right to require a statement of account under subsection (1) terminates when a notice of default is served under section 6.3.

(3) The notice under subsection (1) shall,

(a) be served on the lender;

(b) state that the statement of account is required for the purpose of prepaying the security agreement under section 5.4, if such is the case;

(c) state the effective date for the statement of account, which shall be a date not more than thirty days after the date of the notice; and

(d) enclose the prescribed fee.

(4) The borrower is entitled to receive one statement of account in each twelve month period during the term of the security agreement at no cost to the borrower.

(5) The lender shall serve the statement of account on the person serving the notice within fifteen business days after the date on which service of the notice is effective.

(6) Where the lender fails to comply with subsection (5), the court shall, on the application of the person serving the notice,

(a) order the lender to provide a statement of account to the applicant; or

(b) issue a statement of account to the applicant.

(7) Where the lender fails to comply with subsection (5) without reasonable excuse, the lender is liable to the applicant for any loss or damage caused thereby.

(8) A lender who contravenes subsection (5) without reasonable excuse is guilty of an offence and on conviction is liable to a fine of not more than $2,000.

3.16 (1) In this section, "period" means,

(a) the period between the date the last amount on account of principal was advanced to the borrower under the security agreement and the date of the statement of account, if no statement of account has been previously provided to the borrower; or

(b) the period between the date of the statement of account most recently provided to the borrower and the date of the statement of account.

(2) The statement of account shall be in writing and shall set out, in plain language,

(a) the principal amount due at the beginning of the period;

(b) the amount of payments credited during the period;

(c) the apportionment of payments credited during the period on account of principal, interest, and taxes, or any other matters;

(d) the amount of any payments made by the lender and charged to the security agreement during the period and indicating the nature of the payments;

(e) the status of the tax or any other accounts maintained by the lender in respect of the security agreement at the end of the period;

(f) the principal amount due at the end of the period and the method by which the amount was calculated;

(g) the interest rate or rates charged on the security agreement during the period including the rate on the date of the statement of account;

(h) the amount of any charge assessed against the borrower arising out of the borrower's default, if any, and the nature of the charge;

(i) the amount, if any, required to be paid to bring the security agreement into good standing;

(j) if the statement of account is required for the purpose of prepaying the security agreement, the compensation required to be paid under section 5.4 and the method by which the compensation was calculated;

(k) if the effective date specified in the notice served under subsection 3.15(1) requires the lender to assume that certain payments will be made before the effective date, a statement that it is correct only if such payments are duly made; and

(l) such other information as may be prescribed.

(3) The effective date of the statement of account shall be the date specified as the effective date in the notice given under subsection 3.15(1).

(4) A statement of account is binding on the lender in favour of the person requesting the statement and any person to whom the lender might reasonably expect such person to provide the statement, if the statement is reasonably relied upon to the person's detriment.

(5) Except where the statement of account is issued by the court under clause 3.15(6)(b), the lender may at any time, without prejudice to any rights acquired under subsection (4), send a revised statement to any person who has received the statement of account.

(6) A person who has received a statement of account shall forthwith at the lender's request provide to the lender the names and addresses of those persons who he knows or ought to know have received a copy of a statement of account.

(7) Where a person who has received a statement of account contravenes subsection (6) or is negligent in providing the information required by subsection (6), and thereby causes the lender to be bound by the statement, that person shall indemnify the lender for any loss caused thereby.

(8) Any dispute as to the correctness of the statement of account shall be determined by the court on the application of an interested person.

(9) Despite subsection (4), a statement of account is not binding on the lender where,

(a) it was provided by the lender voluntarily and not in response to a notice served under subsection 3.15(1); and

(b) it states that,

  (i) it is not a binding statement of account;

  (ii) in order to obtain a binding statement of account, the method provided for in section 3.15 must be used; and

  (iii) errors and omissions are excepted from the statement of account.

H. *Discharges*

3.17 (1) The lender shall prepare a release of insurance, discharges of any other security collateral to the security agreement in registrable form, and a discharge of the security agreement in registrable form at no cost to the borrower when,

(a) the obligation whose performance is secured by the security agreement is performed; or

(b) the borrower is otherwise entitled under this Act to a discharge.

(2) The lender shall, within ten business days of the date on which the borrower is entitled to the discharge, serve on the borrower the release of insurance, discharges of any other security collateral to the security agreement, and the discharge, together with a notice advising the borrower to register the discharge in the land registry office where the security agreement is registered, and setting out the address of the land registry office.

(3) Where the lender fails without reasonable excuse to comply with subsection (2), the lender is liable for any loss or damage caused thereby.

(4) Where the borrower requests a discharge, and the lender fails to comply with subsection (2) within ten business days of the date of the borrower's request, and where the court is satisfied that all money due under a security

agreement has been paid, and all covenants performed, the court shall, on the application of the borrower,

(a) order the lender to provide a discharge of the security agreement to the borrower in registrable form, a release of insurance, and a discharge of any other security collateral to the security agreement; or

(b) make an order discharging the security agreement, releasing any insurance on the secured property, and discharging any other security collateral to the security agreement.

(5) When a borrower or any person entitled to pay off a security agreement desires to do so and the lender, or one of several lenders, cannot be found or when a sole lender or the last surviving lender is dead and no letters probate or letters of administration have been issued, or where from any other cause a proper discharge cannot be obtained, or cannot be obtained without undue delay and expense on the application of the borrower or the person,

(a) the court may direct payment into court of the amount due under the security agreement and may make an order under subsection (4);

(b) the money paid into court shall be paid out of court with accrued interest to the lender or to the executor or administrator of the lender or as the court by the order for payment into court or any subsequent order may direct;

(c) the court may require notice to be given to the lender or those claiming under him either before or after making the order by advertisement or in any other manner as is considered proper.

(6) In an application under this section, where an issue arises as to who is entitled to receive payment, or as to the reasonableness or amount of a payment under subsection 6.13(3), the court may as a condition of making the order require payment into court of a sum in excess of the amount admitted to be due and to answer any claim by the lender for subsequent interest and costs and in such case the sum is subject to the further order of the court, and the court may require payment into court of an additional sum.

(7) An order under clause (4)(b) may be registered, is conclusive of the matters determined in the order, and has the same effect as the registration of a certificate of discharge signed by the lender.

3.18 For the purpose of section 3.17, the payment in good faith of any money to and the receipt thereof by the survivor or survivors of two or more lenders, or the executors or administrators of such survivor, or their assigns, effectually discharges the person paying the money from seeing to the application, or being answerable for the misapplication thereof, unless the contrary is expressly declared by the security agreement.

3.19 (1) Where the borrower is entitled to a discharge, the borrower may require the lender, instead of providing the discharge, to assign the security agreement to such third person as the borrower directs and the lender shall assign accordingly.

(2) The right of the borrower to require an assignment belongs to and is capable of being enforced by each encumbrancer, despite any intermediate encumbrance, but a requisition of an encumbrancer prevails over that of the borrower, and as between encumbrancers a requisition of a prior encumbrancer prevails over that of a subsequent encumbrancer.

PART IV

RESIDENTIAL SECURITY AGREEMENTS: DISCLOSURE

4.1 In this Part,

(a) "borrower" means protected borrower and includes a prospective protected borrower;

(b) "lender" means a person who lends money on a security agreement, whether the money is his own or that of another person, and

  (i) includes, in respect of any particular security agreement,

    i. a prospective lender;

    ii. a person who holds himself out as, or who by advertisement, notice or sign indicates that he is, a lender;

    iii. a person who carries on the business of dealing in security agreements;

    iv. a person in whose favour there is a security interest;

    v. a person who is,

      1. acting as a real estate and business broker; or

      2. a member of the Law Society of Upper Canada,

    and is performing a function similar to that of a mortgage broker; and

    vi. a person who takes an assignment of a security agreement from a person described in paragraph 4.1(b)(ii)i within one month after the first payment under the security agreement is made by the borrower;

(ii) but does not include,

i. a purchase-money lender who would qualify to be a protected borrower if he were still the owner of the secured property;

ii. a related lender; or

iii. a lender who lends not more than twice each year a sum not exceeding the prescribed amount on the security of a security agreement;

(c) "related lender" means a lender who is an individual or a corporation that is controlled directly or indirectly by an individual, where the individual is connected to the borrower by blood relationship, marriage, or adoption.

A. *Advertising and Inquiries*

4.2 (1) In this section,

(a) "cost of borrowing" means,

(i) the interest or discount under a security agreement, and

(ii) such amounts in connection with a security agreement as are payable by the borrower to the lender or to any person from whom the lender receives any accounts directly or indirectly and including any service, transaction or activity expenses, and security agreement application fees, finder's fees, brokerage fees, appraisal or inspection fees and other similar fees or bonuses;

(b) "other expenses" means fees, bonuses and other amounts to be paid by the borrower to the lender or to a third party in connection with a security agreement transaction other than amounts included in the cost of borrowing, including,

(i) fees or amounts required by law to be paid to a public official in connection with the loan or for the purpose of making effective or securing the loan,

(ii) the maintenance of a tax or other account by the lender,

(iii) fees for a certificate of search or an examination or copies of registered documents or for similar purposes,

(iv) fees for surveying,

(v) fees and disbursements of lawyers and notaries, and

(vi) fees for insurance in respect of a security agreement.

(2) A lender shall not make representations or authorize or allow representations to be made in response to a written or oral inquiry from a borrower, or in any advertisement, that purports to indicate a rate of interest or other amounts included in the cost of borrowing, unless the statement discloses,

(a) the cost of borrowing, expressed as an annual percentage rate or range of rates, calculated half-yearly not in advance and without deemed reinvestment of periodic payments on account of the amount due under the security agreement, applicable to the class of security agreement being advertised; and

(b) the nature but not necessarily the amount of other expenses not included in the cost of borrowing.

(3) A lender may disclose additional information or explanations, together with the information required to be disclosed, if the additional information or such explanations are not stated, utilized or placed so as to contradict, obscure or distract attention from the information required to be disclosed by subsection (2).

(4) A lender is not bound to enter into a security agreement with the borrower that conforms with the lender's representations under subsection (2) by reason only that the lender has made disclosure in compliance with this section.

(5) A lender who wilfully contravenes subsection (2) is guilty of an offence and upon conviction is liable to a fine of not more than $2,000.

4.3 (1) A lender shall make information questionnaires in the prescribed form available to borrowers at the lender's places of business, at no cost to the borrower, and shall give a copy of the information questionnaire to the borrower at the lender's first opportunity.

(2) A lender who contravenes subsection (1) is guilty of an offence and on conviction is liable to a fine of not more than $1,000.

B. *Disclosure Statements*

4.4 (1) A lender shall provide a disclosure statement in the prescribed form to the borrower at the time when the lender communicates to the borrower the terms on which the lender offers to take a security agreement from the borrower.

(2) The lender's offer shall allow a minimum period of five business days for its acceptance.

(3) Subject to the terms of the disclosure statement, the borrower may respond to the offer at any time after the borrower receives the disclosure statement.

(4) Where there is a conflict between the terms of the disclosure statement and the offer, the terms of the disclosure statement shall prevail.

(5) Where there is a conflict between the terms of the disclosure statement and the security agreement,

(a) as between the lender and the borrower, the individual terms of each document most beneficial to the borrower shall prevail; and

(b) as regards the rights of all other persons, the terms of the security agreement shall prevail.

(6) For the purpose of subsection (1), where more than one lender participates in the making of an offer, the participating lenders may provide a single disclosure statement to the borrower.

(7) Where the lender fails to comply with subsection (1) or subsection (2), the borrower may, at any time within sixty days of the time when the borrower first becomes aware of the lender's breach of this section, exercise the right of prepayment provided in section 5.4 without payment of compensation.

(8) Upon payment under subsection (7), the lender shall provide a discharge to the borrower.

(9) Where there is a conflict between the terms of the disclosure statement and the security agreement, or where the lender fails to comply with subsection (1) or subsection (2), the validity of a security agreement or any proceeding taken to enforce the security agreement are not affected, but the court may in the appropriate circumstances award compensatory damages to the borrower.

(10) Where there is a conflict between the terms of the disclosure statement and the security agreement or where the lender fails to comply with subsection (1) or subsection (2), the lender is guilty of an offence and on conviction is liable to a fine of not more than $2,000.

PART V

RESIDENTIAL SECURITY AGREEMENTS: ADDITIONAL RIGHTS AND OBLIGATIONS OF BORROWER AND LENDER

5.1 In this Part, "security agreement" means residential security agreement.

A. *Plain Language*

5.2 (1) Every security agreement, and every disclosure statement provided under Part IV of this Act, shall,

(a) be written in a clear and coherent manner using words with common and everyday meanings;

(b) have its clauses appropriately divided and captioned;

(c) where the security agreement uses personal pronouns in referring to the lender or borrower, use the second person pronoun in referring to the borrower; and

(d) be written in type of easily readable size.

(2) A lender who contravenes subsection (1) is guilty of an offence and on conviction is liable to a fine of not more than $2,000.

(3) A contravention of subsection (1) does not affect the validity of the security agreement or any proceeding taken to enforce the security agreement.

B. *Clauses Making the Security Agreement Due on Certain Events*

5.3 (1) In this section,

(a) "due-on-sale clause" means a clause in a security agreement that requires or entitles the lender to require the borrower to pay the amount due under the security agreement at the time the borrower sells the secured property;

(b) "unrelated purchaser" means a purchaser who is an individual, or a corporation that is controlled directly or indirectly by an individual, where the individual is not connected to the borrower by blood relationship, marriage or adoption.

(2) Where a security agreement contains a due-on-sale clause, the borrower may, at the time the borrower sells the secured property in good faith to an unrelated purchaser, pay to the lender the amount due under the security agreement at the date of the payment and perform any other obligations secured by the security agreement.

(3) For the purpose of subsection (2), the "amount due" under the security agreement shall not include any charge that arises by agreement or otherwise on the exercise of the borrower's right under subsection (2), and the borrower shall not be required to pay prepayment compensation or any other amounts required by section 5.4.

(4) The borrower shall provide a copy of the agreement of purchase and sale and a copy of the affidavit required under the *Land Transfer Tax Act* to the lender at the lender's request.

(5) The borrower's right to pay under subsection (2) does not apply where the borrower retains or intends to retain an interest in the secured property after the sale, other than an interest as purchase-money lender.

(6) Upon payment under subsection (2), the lender shall provide a discharge to the borrower.

(7) A clause in a security agreement is void if it requires, or entitles the lender to require, the borrower to pay the amount due under the security agreement where,

- (a) the borrower commences negotiations for sale of the secured property or for a subsequent security agreement;
- (b) the borrower enters into a subsequent security agreement;
- (c) the secured property is encumbered by an interest that is subsequent in priority to the security agreement;
- (d) the borrower defaults under a subsequent security agreement; or
- (e) a prior security agreement is renewed in accordance with its terms.

(8) Any dispute under this section shall be determined by the court on application by the borrower or the lender.

C. *Prepayment*

5.4 (1) In this section,

1. "remaining interest amount" means the amount of money required to be paid as interest over the remaining term of a security agreement;
2. "current interest amount" means the amount of money that the borrower would be required to pay as interest over the remaining term of the security agreement if the interest rate in the security agreement were the current interest rate;
3. "current interest rate" means,

(i) the rate of interest charged by the lender on loans secured by security agreements similar to the borrower's security agreement commencing on the prepayment date and having a term not greater than the remaining term of the borrower's security agreement and not less than the shortest term of security agreements taken by the lender;

(ii) where the security agreement provides that for the purpose of prepayment of the security agreement the current interest rate shall be calculated with reference to a lender that is in the business of making loans secured by security agreements similar to the borrower's security agreement, the rate of interest calculated under the security agreement; or

(iii) where the lender is not in the business of making loans secured by security agreements, and the security agreement does not contain an express provision referred to in paragraph (ii), the average rate of interest charged by lenders in the business of making loans secured by security agreements similar to the borrower's security agreement.

(2) For the purpose of the calculation of the current interest rate under paragraph 5.4(1)3(ii), the difference between the current interest rate calculated under paragraph 5.4(1)3(ii) and the current interest rate calculated under paragraph 5.4(1)3(iii) shall not exceed the difference between the interest rate in the borrower's security agreement and the current interest rate under paragraph 5.4(1)3(iii) calculated as at the date of the borrower's security agreement.

(3) Upon payment to the lender of prepayment compensation and the lesser of one month's interest under the security agreement and an amount prescribed, a borrower may prepay the security agreement at any time.

(4) The prepayment compensation payable under a security agreement shall be calculated in accordance with the following equation:

$$\text{Prepayment Compensation} = \frac{\text{remaining interest amount less current interest amount}}{1 + \left(\begin{array}{l}\text{the remaining term of the security agreement in years or}\\ \text{fractions thereof multiplied by the current interest rate}\end{array}\right)}$$

(5) A borrower who exercises the right to prepay provided in subsection (3) shall do so in the manner provided by section 3.15 and has the further rights and remedies provided for in section 3.15.

(6) Any dispute as to the amount due under the security agreement or the calculation of compensation under subsection (3) shall be determined by the court on application of the borrower or the lender.

D. *Assumption of Security Agreement*

5.5 (1) In this section,

(a) "first borrower" means the owner of the secured property at the time a request is made under subsection (2);

(b) "second borrower" means the person to whom the first borrower intends to transfer the secured property.

(2) The first borrower may by a notice in the prescribed form request that the lender approve the assumption by the second borrower of some or all of the first borrower's obligations under the security agreement.

(3) The notice shall be served on the lender.

(4) Where the second borrower has provided such information to the lender as the lender customarily requires in assessing a request for a loan secured by a security agreement, and upon payment of the lender's reasonable costs, the lender shall assess the request and shall consent to the assumption unless the assumption by the second borrower would on commercially reasonable grounds materially affect the lender's risk under the security agreement.

(5) For the purpose of subsection (4),

(a) the lender's reasonable costs may be fixed by regulation;

(b) any dispute as to whether the lender's costs are reasonable shall be determined by the court on application by the first or second borrower or the lender.

(6) Where the lender consents to the assumption, the lender shall,

(a) serve a consent to assumption in the prescribed form on the first borrower; and

(b) send the consent by registered and prepaid first class mail to the second borrower at the address set out in the notice.

(7) Where the lender refuses to consent to the assumption, the lender shall,

(a) serve a refusal to consent to assumption in the prescribed form on the first borrower, setting out the grounds upon which consent is refused; and

(b) send the refusal to consent by registered and prepaid first class mail to the second borrower at the address set out in the notice.

(8) Where the lender does not serve the consent or the refusal to consent on the first borrower and send it to the second borrower within ten business days after the date on which the second borrower provides all the information

required by the lender under subsection (4), the lender shall be deemed to consent to the assumption.

(9) Where the lender has consented or has been deemed to consent to the assumption of some or all of the first borrower's obligations under the security agreement, upon the transfer of the secured property the first borrower ceases to be liable to the lender for such obligations.

(10) Upon the application of the first borrower, the second borrower, or the lender, unless the lender satisfies the court that the lender withheld consent to the assumption by the second borrower of some or all of the first borrower's obligations under the security agreement on the ground set out in subsection (4), the court shall make an order deeming the lender to have consented.

(11) Where a lender who has refused to consent to the assumption brings an action against the first borrower for payment under the security agreement, the first borrower may defend the action on the ground that the lender ought to have consented to the assumption, and subsection (10) applies to the action with necessary modifications.

(12) An order under subsection (10) may be registered and is conclusive of the matters determined in the order.

(13) The liability to the lender under this section of a person who is no longer the owner of the secured property ceases unless the lender makes a demand for payment on the person or his guarantor within six months after the term of the security agreement has expired.

PART VI

REMEDIES

6.1 (1) This Part applies where the borrower is in default under a security agreement.

(2) In this Part,

(a) "waiting period" means the period of time between the date of default under the security agreement and the date set out in the notice of sale under subsection 6.5(2);

(b) "subsequent encumbrancer" in respect of a security agreement means the persons entitled to be sent a notice of sale under subsection 6.6(1).

6.2 (1) For the purposes of this Part, where a receiver or receiver-manager has been appointed, "lender" includes the receiver or receiver-manager.

(2) A receiver or receiver-manager shall not be appointed by agreement of the parties to a security agreement or by order of the court if the security agreement is a residential security agreement.

A. *Notice of Default*

6.3 (1) The lender may serve a notice of default in the prescribed form on the borrower.

(2) The notice of default shall not be served until the default has continued for at least ten business days.

(3) The notice of default shall be in writing and shall set out in plain language,

(a) the default or defaults under the security agreement;

(b) the rights and remedies of the lender and the borrower on default; and

(c) such other information as may be prescribed.

(4) The lender shall attach to the notice of default a statement of account in which the effective date is the date on which the lender intends to serve a notice of sale on the borrower.

(5) A contravention of subsection (1), (2) or (3) does not affect the validity of the notice of default or any proceeding taken to enforce the security agreement unless in the opinion of the court the borrower has been prejudiced thereby.

(6) Where the lender fails to comply with subsection (4) the right of the lender to enforce the security agreement is suspended until the lender has complied with subsection (4).

(7) At any time before a notice of sale is served, the borrower may,

(a) pay the arrears of money due under the security agreement at the time of payment;

(b) perform any other covenants due to be performed under the security agreement as set out in the notice of default; and

(c) where the lender has performed a covenant on behalf of the borrower by making a payment to a third party, pay the amount of such payment,

and thereupon the borrower is relieved from the consequences of the default.

(8) For the purpose of subsection (7), ''arrears'' means the difference between,

(a) the amounts the borrower ought to have paid under the security agreement not including any amount that is payable under the security agreement by reason of the default alone; and

(b) the amount the borrower actually paid under the security agreement,

and includes payments made by the lender for the reasonable protection of the lender's security interest including taxes, insurance premiums, condominium maintenance fees and costs of commercially reasonable repairs.

(9) For the purpose of subsection (7), any dispute as to the arrears of money due under the security agreement, the performance of other covenants by the borrower, or the borrower's compliance with subsection (7) may be determined by the court on application of the borrower or the lender.

(10) In an application under subsection (9),

(a) where the borrower has complied with subsection (7), the court may make an order declaring that the borrower is relieved from the consequences of the default; or

(b) where the borrower has not complied fully with subsection (7), and the court is satisfied that the borrower,

(i) has attempted in good faith to comply with subsection (7); and

(ii) has proceeded expeditiously in the application under subsection (9),

the court may grant to the borrower an additional five business days in which to comply with the order of the court under subsection (9) and upon such compliance the borrower is relieved from the consequences of the default.

B. *Power of Sale*

6.4 Subject to this Part, the lender has the power to sell the secured property in whole or in part unless the security agreement provides to the contrary.

C. *Notice of Sale*

6.5 (1) Where a borrower is in default under a security agreement for ten or more business days after the date that service of the notice of default was effective and while the default continues, the lender may serve a notice of sale in the prescribed form on the borrower.

(2) The notice of sale shall specify the date after which the lender intends to take steps to sell the secured property.

(3) The date set out in the notice of sale shall be the later of,

(a) four months after the date of the default in respect of which the notice of default was served on the borrower; and

(b) two months after the date that notice of sale was served on the borrower.

(4) The lender shall attach to the notice of sale a statement of account in which the effective date shall be the date specified in the notice of sale under subsection (2).

(5) A contravention of subsection (1), (2) or (3) does not affect the validity of a notice of sale or any proceeding taken to enforce the security agreement unless in the opinion of the court the borrower has been prejudiced thereby.

(6) Where the lender fails to comply with subsection (4) the right of the lender to enforce the security agreement is suspended until the lender has complied with subsection (4).

6.6 (1) The lender shall serve the notice of sale together with a copy of the statement of account referred to in subsection 6.5(4) on the following persons, other than persons whose interests in the secured property are prior to the interest of the lender,

(a) where the secured property is registered under the *Land Titles Act*, each person appearing to have an interest in the secured property by the register of title and by the index of executions;

(b) where the secured property is registered under the *Registry Act* each person appearing to have an interest in the secured property by the abstract index and by the index of writs received for execution by the sheriff of the county or district in which the secured property is situate;

(c) where there is a statutory lien against the secured property in favour of the Crown or any other public authority and where the lender sending the notice of sale has written notice of the lien, the Crown or other public authority claiming the lien;

(d) where the lender has actual notice of any other interest in the secured property and where such notice has been received prior to the sending of the notice of sale, the person having such interest;

(e) where the property is a matrimonial home within the meaning of Part II of the *Family Law Act, 1986*, to the spouse of the borrower unless,

  (i) the spouse has released all rights under Part II of the Act by a separation agreement,

  (ii) a court order has been made releasing the property as a matrimonial home, or

  (iii) the property ceases to be designated as a matrimonial home pursuant to the provisions of that Act; and

(f) the guarantor of the borrower.

(2) In subsection (1), the expressions "register of title" and "abstract index" include entries of instruments received for registration before 4:30 p.m. on the day immediately prior to the day on which the notice of sale is sent.

6.7 (1) Subject to this Part, during the waiting period no steps shall be taken by the lender to sell the secured property.

(2) A contravention of subsection (1) does not affect the validity of a sale of the secured property but the court may in the appropriate circumstances award compensatory damages to the borrower or a subsequent encumbrancer.

6.8 Nothing in this Part shall be considered to abridge,

(a) the period of default after which notice of sale may be given where the period of default provided in the security agreement is greater than the period of default mentioned in subsection 6.5(1); or

(b) the period of time after notice of sale has been given after which the secured property may be sold where the period of time provided by the security agreement is greater than the period of time mentioned in subsection 6.5(3).

6.9 (1) At any time between the date that notice of sale is served on the borrower or a subsequent encumbrancer, and the date on which the interest of the borrower or the subsequent encumbrancer in the secured property is extinguished under section 6.12, the borrower or the subsequent encumbrancer may,

(a) pay the arrears of money, as defined in subsection 6.3(8), due under the security agreement at the date of payment;

(b) perform any other covenants due to be performed under the security agreement;

(c) where the lender has performed a covenant on behalf of the borrower by making a payment to a third party, pay the amount of the payment; and

(d) pay the expenses reasonably incurred by the lender in exercising the rights and remedies in this Part to the date of payment,

and thereupon the borrower is relieved from the consequences of the default.

(2) Except where the borrower is a protected borrower, the borrower or a subsequent encumbrancer may not exercise the right provided in subsection (1) without the consent of the lender if the borrower or any subsequent encumbrancer has exercised the right within the preceding twelve months.

(3) For the purpose of subsection (1), any dispute as to the arrears of money due under the security agreement, the performance of other covenants by the borrower, compliance with subsection (1), or the reasonableness of the expenses incurred by the lender shall be determined by the court on application by the borrower, the lender or any subsequent encumbrancer.

(4) In an application under subsection (3),

(a) where the borrower or subsequent encumbrancer has complied with subsection (1), the court may make an order declaring that the borrower is relieved from the consequences of the default; or

(b) where the borrower or subsequent encumbrancer has not complied fully with subsection (1), and the court is satisfied that the borrower,

(i) has attempted in good faith to comply with subsection (1); and

(ii) has proceeded expeditiously in the application under subsection (3),

the court may grant to the borrower or subsequent encumbrancer an additional five business days in which to comply with the order of the court under subsection (3) and upon such compliance the borrower is relieved from the consequences of the default.

6.10 (1) A lender or any subsequent encumbrancer may, without notice to the borrower, apply to the court for leave to sell the secured property.

(2) In an application under subsection (1), the court shall, having regard to the circumstances, either grant leave to exercise the power of sale without notice or with such notice to such persons, in such manner and within such time as the court considers proper.

(3) The order under subsection (2) is conclusive of the matters determined in the order.

D. *Conduct of Sale*

6.11 (1) After the waiting period the lender may sell the secured property.

(2) The borrower may consent to the sale of the secured property at any time if the consent,

(a) is in writing; and

(b) has not been sought or given until after the notice of sale has been served.

(3) The sale of the secured property may be by tender, public sale, private sale, by one or more contracts, as a unit or in parcels, at any time and place and on any terms including sale on credit, but every aspect of the sale, including advertising, time of day, place and terms must be commercially reasonable having regard to the nature of the secured property and the circumstances of the disposition.

(4) The lender may, to the extent that it is commercially reasonable, repair or otherwise prepare the secured property for sale.

(5) Where it is commercially reasonable, the lender may employ an agent to conduct or assist in conducting the sale.

(6) In determining whether a matter was or is commercially reasonable, a court shall not have regard to any failure by the lender to delay the sale.

(7) Where the sale has not been carried out in a commercially reasonable manner, the lender and any agent employed by the lender to conduct the sale or to assist in conducting the sale are jointly and severally liable for any loss or damage caused thereby to the borrower or to any persons who had an interest in the proceeds of sale.

(8) No action may be brought under subsection (7) more than two years from the date on which the interest of the borrower in the secured property is terminated under section 6.12.

(9) A security agreement may set out the standards of commercial reasonableness by which the rights of the borrower and the duties of the lender in respect of the sale are to be measured, if the standards are not unreasonable having regard to the nature of the rights and duties.

(10) Subsection (9) does not apply to residential security agreements.

(11) Except where permitted under subsection 3.5(4), the lender shall not, directly or indirectly, purchase the secured property.

E. *Effect of Sale*

6.12 (1) The sale of the secured property extinguishes the security agreement of the lender making the sale and, if the sale is made to a purchaser who purchases in good faith for value, also extinguishes the interests of the borrower and subsequent encumbrancers in the secured property.

(2) For the purpose of subsection (1), the sale takes place at the moment the lender accepts a written offer to purchase the secured property.

(3) Subsection (2) applies despite the fact that the written offer to purchase the secured property is subject to a condition that is not fulfilled at the moment the lender accepts the offer.

(4) Where the agreement referred to in subsection (2) is terminated before the secured property is transferred to the purchaser, the interests extinguished under subsection (1) and the rights under section 6.9 are revived.

(5) On the termination of an agreement referred to in subsection (2), the lender shall immediately advise the borrower and serve a written notice of the termination on the borrower and subsequent encumbrancers.

(6) A contravention of subsection (5) does not affect the validity of a subsequent sale of the secured property by the lender, but the court may in the appropriate circumstances award compensatory damages to the borrower or a subsequent encumbrancer.

(7) Subject to the *Land Titles Act*, a purchaser in good faith for value without actual notice of any contravention of this Part may rely on a statutory declaration by the lender, his solicitor or agent as to,

(a) default;

(b) proving service of the notice of default and the notice of sale, including production of the post office receipt of registration; and

(c) compliance with this Part, including an order under section 6.10, in the conduct of the sale,

and is not obliged to enquire further as to the sufficiency of such compliance.

(8) The lender shall, within twenty business days of the date on which the secured property is conveyed to the purchaser, prepare and serve on the borrower and subsequent encumbrancers a written report setting out the particulars of the sale and the disposition of the proceeds of the sale.

F. *Application of Proceeds of Sale*

6.13 (1) The proceeds of the sale of the secured property shall be applied consecutively to,

(a) the commercially reasonable expenses of taking possession, administering the secured property under section 6.30, repairing, preparing for sale and selling the secured property, including the expenses of employing an agent to conduct or assist in conducting the sale;

(b) the satisfaction of all interest, costs and other amounts then due under the security agreement under which the sale was made;

(c) the satisfaction of all principal money then due under the security agreement under which the sale was made; and

(d) the payment of the amounts due to the subsequent encumbrancers according to their priorities,

and the surplus, if any, shall be paid to the borrower.

(2) Any money to be paid to execution creditors under subsection (1) shall be paid to the sheriff for distribution under the *Creditors' Relief Act*.

(3) Where there is an issue as to who is entitled to receive payment under subsection (1), or the reasonableness or amount of any payment, the borrower, the lender or any interested person may apply to the court for directions.

(4) Where a surplus arises under subsection (1) and the lender is unable to pay the surplus to the borrower, the lender shall pay the money into court.

6.14 Where a lender obtains money from any source in respect of the lender's interest in the secured property, the money shall be applied by the lender in the manner provided in section 6.13, with necessary modifications.

G. *Foreclosure*

6.15 (1) Where, after the notice of sale has been served on the borrower, it appears that the proceeds of a sale of the secured property would not exceed the amounts to be paid under clauses 6.13(1)(a) to (c), the lender may deliver a notice in the prescribed form requesting consent to foreclosure.

(2) The notice shall be served on the borrower and subsequent encumbrancers.

(3) The lender shall attach to the notice,

(a) copies of all appraisal reports on the secured property in the lender's control or possession;

(b) where the borrower is a protected borrower, a statement in plain language describing the consequences of consenting or refraining to consent to foreclosure; and

(c) a consent to foreclosure in the prescribed form.

(4) The borrower and subsequent encumbrancers may without liability to the lender,

(a) consent to the foreclosure by returning the consent to foreclosure form to the lender; or

(b) refuse consent to the foreclosure by serving a written objection on the lender, but where the notice under subsection (1) is delivered after the waiting period, consent may be refused only where there are reasonable grounds to believe that the proceeds of sale would exceed the amounts to be paid under clauses 6.13(1)(a) to (c).

(5) Consent given by a borrower or subsequent encumbrancer under subsection (4) may not be withdrawn.

(6) If the notice under subsection (1) is delivered after the waiting period, and the borrower and any subsequent encumbrancers do not serve the written objection on the lender within twenty business days of the date on which service of the notice is effective, the borrower and such subsequent encumbrancers shall be deemed to consent to the foreclosure.

(7) Where the borrower and the subsequent encumbrancers consent or are deemed to consent to the foreclosure, the lender may register a certificate of foreclosure in the prescribed form.

(8) A purchaser in good faith without actual notice of any contravention of this section may rely on the statutory declaration of the lender or his solicitor or agent as to the matters set out in this section and is not obliged to enquire further into those matters.

6.16 (1) Where the lender is unable to sell the secured property for an amount exceeding the amounts to be paid under clauses 6.13(1)(a) to (c) within three months after the last day of the waiting period, or where consent to foreclosure has been refused after the waiting period has expired and the lender would be unable to sell the secured property for such an amount, the lender may apply to the court for an order granting leave to register a certificate of foreclosure in the prescribed form.

(2) Notice of the application shall be served on the borrower and subsequent encumbrancers at least ten business days before the application is scheduled to be heard.

(3) Where the court is satisfied that the application is proper under subsection (1) and that the lender has complied with section 6.5 and section 6.6, the court shall make an order granting leave to the lender to register a certificate of foreclosure.

6.17 (1) Upon the registration of a certificate of foreclosure in respect of a security agreement,

(a) title to the secured property passes to the lender named in the certificate;

(b) the indebtedness and any other obligation of the borrower to the lender under the security agreement are satisfied;

(c) the security agreement is discharged and extinguished;

(d) any interests in the property subsequent in priority to the security agreement are extinguished; and

(e) the interest of the borrower in the secured property is terminated and the borrower is not thereafter entitled to reopen the foreclosure on any grounds other than fraud on the part of the lender in obtaining the certificate.

H. *Action on the Covenant*

6.18 (1) An action by a lender for payment on the covenant to pay in a security agreement shall not be commenced by the lender until a notice of sale has been served on the borrower, but where the lender serves the notice of sale on the borrower personally, the lender may at the same time serve a statement of claim on the borrower.

(2) Where the lender does not claim possession or the right to sell the secured property in the action,

(a) section 6.3 applies, and the statement of claim shall not be served until the expiry of ten business days from service of the notice of default, except that the borrower's right under subsection 6.3(7) terminates when the statement of claim is served by the lender; and

(b) section 6.9 applies with necessary modifications except that the borrower's right under subsection 6.9(1) terminates when the lender obtains judgment in the action.

(3) During the waiting period the lender may obtain judgment in the action and subject to section 6.21 may obtain a writ of possession in accordance with the Rules of Civil Procedure.

(4) Subsection (2) does not apply where the action is for any deficiency remaining after the proceeds of sale, if any, have been applied in accordance with clauses 6.13(1)(a) to (c).

6.19 (1) The following persons are jointly and severally liable to the lender in an action on the covenant to pay in a security agreement:

(a) the owner of the secured property on the date of the sale unless the transfer by which the owner acquired title to the secured property provided that the owner was not liable to indemnify the transferor with respect to the security agreement;

(b) any borrower who assumed, or is deemed to have assumed, and continues to have the obligation to pay the amount due under the security agreement under section 3.6 or by agreement with the lender;

(c) subject to section 5.5, the borrower who executed the security agreement; and

(d) subject to the terms of any guarantees, the guarantors of the persons referred to in clauses (a) to (c).

(2) Subject to any express agreement to the contrary, subsection (1) does not apply to a subsequent lender who accepts a quit claim from the borrower and becomes owner of the secured property.

6.20 (1) In this section, "construction security agreement" means any security agreement made for the purpose of financing the construction of a building.

(2) Where a security agreement expressly states that it is a construction security agreement made under this section, no action may be brought by the lender after the expiration of one year from the date of the maturity of the security agreement to recover payment from the person who executed the security agreement of the whole or any part of the moneys therein secured, if such person has made a *bona fide* sale of the property and has transferred the secured property under such circumstances that the transferee is by express covenant or otherwise obligated to indemnify such person with respect to the security agreement.

I. *Possession of the Secured Property*

6.21 (1) Subject to the terms of the security agreement other than a residential security agreement, a lender is not entitled to possession of the secured property unless there has been a default under the security agreement.

(2) Where the borrower is a protected borrower, the court shall grant leave to the lender to issue a writ of possession at any time after default, but the order granting leave shall provide that the date of the writ of possession shall be the day following the last day of the waiting period.

(3) Subject to subsection (2), the date of the writ of possession shall be the date on which the court grants leave to the lender to issue the writ.

(4) Nothing in this section shall be applied to abridge the period of time provided in a security agreement after which the lender may obtain possession of the secured property.

(5) The borrower may consent to give possession of the secured property to the lender at any time provided that the consent

(a) is in writing; and

(b) has not been sought or given until after the notice of sale has been served.

6.22 (1) A lender may at any time apply to the court for leave to issue a writ of possession without notice to the borrower.

(2) In an application under subsection (1), the court may, having regard to the circumstances, grant leave to issue the writ of possession without notice or with such notice to such persons, in such manner and within such time as the court considers proper.

(3) Among the circumstances to be considered by the court in an application under subsection (1) shall be,

(a) the abandonment or apparent abandonment of the secured property by the borrower; and

(b) the commission, or the failure to prevent the occurrence, of waste of the secured property.

J. *Extra-Judicial Possession*

6.23 (1) Despite section 6.21, where the secured property has been or appears to have been abandoned by the borrower, the lender may take possession of the secured property without obtaining a writ of possession.

(2) The lender shall serve a notice of possession under subsection (1) in the prescribed form on the borrower, and shall post the notice at a conspicuous place on the secured property.

(3) Where the lender takes possession of the secured property under subsection (1) and the borrower has not abandoned the secured property,

(a) the lender shall permit the borrower to retake possession of the secured property; and

(b) the lender is liable to the borrower for any actual loss or damage suffered by the borrower as the result of the lender's possession of the secured property, but the lender is not liable under this clause if the court is satisfied that at the time the lender took possession of the secured property,

  (i) the evidence available to the lender, including the condition of the secured property, would have led a reasonable person to believe that the borrower did not intend to return; and

  (ii) the lender made reasonable efforts to ascertain the intention of the borrower.

K. *Chattels Found on the Secured Property*

6.24 (1) Where the lender takes possession of the secured property and finds chattels on the secured property, the lender shall conduct a search as may be appropriate in the circumstances, against the name of the borrower, of the individual debtor index, business debtor index, or motor vehicle index established under the *Personal Property Security Act* and of motor vehicles for which permits have been issued under the *Highway Traffic Act*.

(2) Where it appears to the lender, by reason of the searches conducted under subsection (1) or otherwise, that a person has an interest in any of the chattels, the lender shall give notice in writing by prepaid first class mail to such person that the lender has taken possession of the chattels.

(3) Where it appears to the lender, by reason of the searches conducted under subsection (1) or otherwise, that no person has an interest in any of the chattels, or where any person who has an interest does not respond to the lender's notice within fifteen business days after the notice was sent, the lender may, without liability to the borrower, the true owner of the chattels, or any person having an interest in the chattels, sell or otherwise dispose of the chattels in a commercially reasonable manner.

(4) Where the chattels are sold or otherwise disposed of under subsection (3), if the sale or disposition is made to a person who acquired the chattels in good faith, the disposition discharges the interests of any other person in the chattels or the proceeds of disposition.

(5) The title of a person who acquires the chattels under subsection (3) in good faith without actual notice of any contravention of this Part is not liable to be impeached on the ground that there has not been compliance with the provisions of this Part, but any other remedy available to a person prejudiced thereby against the lender is not affected by this subsection.

(6) The court may on the application of the lender or any interested person determine the validity of any claim made to an interest in the chattels.

(7) The lender may rely on the order of the court given under subsection (6) without liability to any person.

(8) Where the lender disposes of a chattel by sale, the proceeds of disposition shall be applied consecutively to,

(a) the reasonable expenses of disposing of the chattel, including the expenses of processing or preparing the chattel for disposition; and

(b) payment in accordance with section 6.13.

(9) Where the lender retains the chattels for his use, the lender shall account to the borrower and subsequent encumbrancer for the value of the chattels and section 6.13 applies with necessary modifications.

(10) Where the lender is satisfied that a person has an interest in a chattel, the lender shall, without liability to the borrower, the true owner of the chattel, or any person having interest in the chattel, permit such person to take possession of the chattel in which the person claims an interest.

6.25 (1) Subject to subsection (6), despite any agreement to the contrary, the right of a lender to distrain for interest in arrears upon a security agreement is limited to chattels of the borrower that are not exempt from seizure under execution.

(2) Where there is an execution creditor of the borrower, or an assignment for the general benefit of the borrower's creditors, the distraint of the lender under subsection (1) shall be for an amount not exceeding one year's arrears of interest or rent under the security agreement and the reasonable cost of executing distraint and sale.

(3) The restriction in subsection (2) does not apply unless notice in writing is given to the lender distraining or his attorney, bailiff, or agent before such lawful sale by the person who claims the benefit of the restriction.

(4) When notice is given under subsection (3), the lender shall relinquish to the person giving notice the chattels distrained, upon receiving one year's arrears of such interest or rent and the reasonable costs of distress, or if such arrears and costs are not paid or tendered the lender shall sell only so much of the chattels distrained as necessary to satisfy one year's arrears of such interest or rent and the reasonable costs of distress and sale, and shall thereupon relinquish any residue of them, and pay any residue of the proceeds to the person giving notice.

(5) Chattels distrained by a lender shall not be sold except after such public notice as is required to be given by a landlord who sells goods and chattels distrained for rent.

(6) The lender under a residential security agreement has no right to distrain against the borrower's chattels.

L. *Leases and Tenancies*

6.26 Where the lender takes possession of secured property that is subject to a lease that is prior in interest to the security agreement, the lender becomes the landlord of such part of the secured property as is subject to the lease.

6.27 (1) Where the lender takes possession of secured property that is residential premises as defined in Part IV of the *Landlord and Tenant Act*, and is subject to a lease or oral tenancy agreement that is subsequent in interest to the security agreement that,

(a) provides for a commercially reasonable rent for the premises, as determined at the date the lease or oral tenancy agreement was entered into;

(b) provides for payment of rent in periodic instalments payable not more than three months in advance;

(c) subject to clause (d), provides that the tenant is required to take possession of the premises not more than six months after the date of the lease;

(d) where the premises are under construction at the date of the lease, provides that the tenant is required to take possession of the premises upon completion of construction of the premises,

the lease or oral tenancy agreement is effective against the lender for the period of its unexpired term, but not less than 120 days and not more than one year from the date the lender takes possession of the secured property.

(2) Where the lender takes possession of the secured property that is subject to a lease or oral tenancy agreement, the lender shall serve written notice on the tenants advising that the lender has taken possession and has become landlord, and setting out the date on which the lender is entitled to obtain vacant possession of the secured property.

(3) The lender becomes the landlord for all purposes.

(4) Any dispute as to the matters referred to in subsection (1) shall be determined by the court on the application of the lender or the tenant.

(5) Despite Part IV of the *Landlord and Tenant Act*, at the end of the period referred to in subsection (1) the tenant shall give vacant possession of the premises to the lender, and the lender may apply to the court to obtain a writ of possession in respect thereof.

6.28 (1) Where the lender takes possession of secured property that contains premises, including residential premises, that is subject to a lease or oral tenancy agreement other than one to which section 6.26 or section 6.27 apply, the lender may send a notice to quit in the prescribed form to the premises by registered and prepaid first class mail addressed to the tenant in possession of the premises.

(2) The notice to quit shall specify a date on which the tenant shall give vacant possession of the premises to the lender, not less than ten days from receipt of the notice.

6.29 The lender may apply to the court for a writ of possession in respect of the premises at any time, but the order granting leave to issue a writ of possession shall provide that the date of the writ of possession shall be the day following the date for vacant possession specified in the notice to quit.

M. *Lender in Possession*

6.30 (1) A lender or the lender's agent shall use commercially reasonable care in the custody and preservation of secured property that is in the lender's possession.

(2) If the lender or the lender's agent fails to comply with subsection (1), the lender and the lender's agent, if any, are jointly and severally liable for any loss or damage caused to any person, including the borrower, subsequent encumbrancers, and guarantors, who, in the reasonable contemplation of the lender or the lender's agent, might suffer such loss or damage.

(3) For the purpose of subsection (2), the lender shall indemnify the borrower for loss or damage caused by the lender's breach of subsection (1).

(4) A security agreement may set out the standards by which the rights of the borrower and the duties of the lender are to be measured, so long as those standards are not unreasonable, having regard to the nature of the rights and duties, but the standards do not affect the rights of third persons under subsection (2).

(5) Subsection (4) does not apply to residential security agreements.

(6) For the purpose of the application of section 6.14 to proceeds received by the lender while in possession of the secured property, "commercially reasonable expenses" includes,

(a) reasonable compensation to be paid to the lender for the lender's care and trouble in administering the secured property, including the costs of any commercially reasonable repairs; and

(b) reasonable compensation paid by the lender to an agent employed by the lender to administer the secured property, if it was commercially reasonable to employ such an agent.

(7) The court may, on application of the borrower, the lender or any interested person, determine whether any matter required by this section to be commercially reasonable is commercially reasonable.

N. *Attornment of Rents*

6.31 (1) Where a borrower who is entitled to receive rent in respect of the secured property is in default under the security agreement, the lender may send a notice of attornment of rent in the prescribed form by registered and prepaid first class mail to the secured property addressed to the tenant in possession of the secured property.

(2) The notice shall be in writing and shall set out, in plain language,

(a) the reason for the notice;

(b) the rights and remedies of the lender, the borrower and the tenant in respect of the notice; and

(c) such other information as may be prescribed.

(3) The lender shall immediately serve a copy of the notice on the borrower.

(4) Subject to subsection (8), upon receipt of the notice, the tenant shall pay any amounts, including arrears of rent, otherwise payable to the borrower or at the borrower's direction, in the manner prescribed in the notice until directed otherwise by the lender or the court.

(5) Payment in good faith by the tenant in accordance with the notice is a valid discharge, as between the tenant and the borrower, to the extent of the payment.

(6) If the tenant fails without reasonable excuse to comply with subsection (4), the tenant is liable to the lender for the rent, including any rent paid to the borrower while the notice of attornment was in force.

(7) A tenant is not bound to inquire concerning any default or other circumstances affecting the right of the lender giving the notice.

(8) Where the tenant receives notices from more than one lender, the tenant shall comply with the notice from the lender having the prior interest in the secured property.

(9) Where there is a dispute concerning attornment of rent, any interested person may apply to the court for directions.

(10) Where the tenant brings an application under subsection (9), the tenant is entitled to solicitor and client costs to be fixed by the court at the hearing of the application and set off against the rent that the tenant is obliged to pay, unless the court orders otherwise.

(11) A landlord and tenant relationship does not arise for the reason only that the lender sends the notice, the tenant or lessee complies with the notice, and the lender accepts payment.

O. *Marshalling*

6.32 The doctrine of marshalling applies to security agreements.

P. *Consolidation*

6.33 The doctrine of consolidation is abolished.

PART VII

MISCELLANEOUS

A. *Service*

7.1 (1) In this section, the "designated address" of a person means the address for service set out in the security agreement or the instrument under which the person claims an interest in the secured property.

(2) Where this Act permits or requires a document to be served on a person, it may be served personally in the manner provided in the Rules of Civil Procedure, or it may be served by mail or as otherwise provided in this section.

(3) Unless otherwise provided in this Act, where a document is served on the borrower by mail, it shall be sent both by registered and by prepaid first class mail,

(a) to the borrower's designated address;

(b) to the borrower's last known address, if the sender knows the designated address is no longer valid; or

(c) to the secured property, if the sender knows that the borrower's designated address and last known address are no longer valid.

(4) Where a document cannot be served under clause (3)(c) by reason that,

(a) there is no municipal address for the secured property; or

(b) the secured property is vacant land,

the document is validly served if it is posted at a conspicuous place on the secured property.

(5) Unless otherwise provided in this Act, where a document is served on the lender by mail, it shall be sent by registered mail,

(a) to the lender's designated address;

(b) to a branch or other office of the lender where the borrower normally makes payment, if the sender knows the designated address is no longer valid; or

(c) such other address of the lender known to the sender, if the sender knows that designated address is not valid.

(6) Where a document is served on any other person by mail, it shall be sent both by registered and by prepaid first class mail,

(a) to the person's designated address;

(b) to a branch or other office of the person if the sender knows the designated address is no longer valid; or

(c) such other address of the person known to the sender, if the sender knows the designated address is no longer valid.

(7) Where the person is an execution creditor, the document may be served in the manner provided in subsection (6) by addressing it to the solicitor who issued the execution.

(8) Where the person is a construction lien claimant, the document may be served in the manner provided in subsection (6) by addressing it to the solicitor who filed the claim for lien, but where there is no solicitor and no address for service is shown on the claim for lien and the lender has no actual knowledge of the lien claimant's address, the document need not be served on such lien claimant.

(9) Service of a document by mail is effective on the fifth business day after the document is mailed.

(10) Where a person is under a disability, a notice of sale is effectually served if sent in accordance with subsections (6) to (8).

(11) Where a person has died, notice of sale is served if sent in the manner provided in subsections (6) to (8), and, subject to clause 6.6(1)(d), shall be deemed to be effectual notice to all persons who have any interest in the deceased's estate.

(12) The service of a document is not invalid by reason only of the server's failure to comply strictly with this section.

(13) A document shall be deemed to have been validly served where the court is satisfied that the contents of the document came to the attention of the person to be served.

(14) Where it appears to the court that it is impractical for any reason to effect service of a document in the manner provided in subsections (2) to (8), the court may make,

(a) an order for substituted service;

(b) an order dispensing with service; or

(c) such other order as is just.

(15) Where it appears to the court that a document served on a person in accordance with this Act,

(a) did not come to his notice; or

(b) came to his notice only at some time later than when it was served,

the court may set aside the consequences of the person's failure to respond to such document on such terms as are just.

7.2 (1) Where a person may require a document to be provided by another person under this Act, the requisition may be made on behalf of such person by a solicitor.

(2) Where the requisition of a document has been made by a solicitor and service of the document on the person making the request is otherwise required, the requirement for service on the person is satisfied when the document is sent by registered mail to the solicitor making the requisition.

(3) No person is liable for responding in good faith under this section to a requisition made by a person falsely representing himself to be a solicitor authorized to act on behalf of another person.

B. *Powers of the Court*

7.3 (1) The court shall fix the costs of an application brought under this Act at the hearing, unless in the circumstances it would be inappropriate to do so.

(2) Where an application is brought arising out of the lender's failure, without reasonable excuse, to comply with,

(a) section 3.15 (statement of account);

(b) section 3.17 (discharge);

(c) section 5.4 (prepayment);

(d) section 5.5 (assumption),

the court shall award the costs of the application to the applicant on a solicitor and client basis to be paid forthwith.

(3) The court may order that the costs be added to or subtracted from the amount due under the security agreement.

7.4 (1) Despite any Act or rule of law or equity, the court shall not restrain temporarily or permanently any act properly taken in accordance with this Act, except with the consent of the parties.

(2) Unless otherwise provided in this Act, and despite any Act or rule of law or equity, the court shall not grant an extension of time for the doing of any act, or adjourn or stay an application under this Act, except with the consent of the parties.

7.5 Nothing in this Act shall be construed to derogate from the power and jurisdiction of the court to grant relief,

(a) on the ground that a transaction involving a security agreement or any provision in a security agreement is unconscionable, or

(b) under the *Unconscionable Transactions Relief Act*.

C. *Regulations*

7.6 The Lieutenant Governor in Council may make regulations providing for any matter that is required by this Act to be prescribed or made by regulation.

D. *Transitional*

7.7 (1) Subject to subsection (2) and subsection (3), this Act applies to all security agreements in existence on the date on which this Act comes into force.

(2) Part IV of this Act does not apply where the security agreement was registered before the date on which this Act comes into force.

(3) A security agreement is subject to Part IV of this Act only to the extent that the disclosure obligation arises subsequent to the date on which the Act comes into force.

E. *Amendment to Statute Law*

7.8 The *Mortgages Act*, being chapter 296 of the Revised Statutes of Ontario, 1980, is repealed.

F. *General*

7.9 This Act comes into force on a day to be named by proclamation of the Lieutenant Governor.

7.10 The short title of this Act is the *Land Security Act, 19*

APPENDIX 2

Mortgage Brokers Act, Form 2
Under R.R.O. 1980, Reg. 662

Form 2
Mortgage Brokers Act
STATEMENT OF MORTGAGE

This form must be completed in duplicate in accordance with the regulations under the Mortgage Brokers Act and a signed copy given to the borrower at least 24 hours before he is asked to sign any mortgage documents.

Property Mortgaged (address and description of buildings) ....

....

....

1. Principal amount of the .... (REGULAR OR COLLATERAL) ; .... (1ST, 2ND, 3RD) Mortgage to be repaid by the Borrower .... $____________
2. Deduct Bonus, Charges, Fees, etc. (This amount must equal total items under Section 8) .... $____________
3. Amount of money to be paid to the Borrower or to be disbursed on his direction is .... $____________
4. THE MAXIMUM ANNUAL EFFECTIVE RATE OF INTEREST ON THIS MORTGAGE IS .... %

   (This rate will be higher than the rate shown below in item 5, whenever there is a bonus charged).
5. The Principal amount of the Mortgage (item 1) of $____________ will bear interest at _____ % per year and will be repayable in ____________ (MONTHLY OR QUARTERLY) instalments of $____________ (PLUS OR INCLUDING) interest.
6. The Mortgage will become due and payable in _____ years at which time the Borrower, if all payments are made on the due date will owe .... $____________
7. The Mortgage is not renewable on the same terms as item 5 above and does not contain any privileges or penalties except as follows: ....

   ....
8. The BONUS, Charges, Fees, etc., to be deducted from the Principal amount of the Mortgage under item 2 above, are made up as follows:

   BONUS on Mortgage .... $____________

   Brokerage Fees or Commissions .... $____________

   Inspection and Appraisal Fees .... $____________

   Lawyer's Fees and Estimated Disbursements of not more than .... $____________

   Other Charges .... $____________ $____________

   TOTAL as shown in item 2 above .... $____________

This Mortgage shall be arranged on or before the . . . . day of . . . . . . 19 . . . .

I ______________________________ of ______________________________
NAME ADDRESS

the Borrower under this proposed Mortgage, have read and fully understand the above Statement furnished me by ______________________________

____
NAME AND ADDRESS OF BROKER

I have not yet signed any Mortgage papers or Blank Documents on this mortgage and now sign this Statement in duplicate, which has been fully completed this ________ day of ____________ 19________, and I hereby acknowledge receipt of a fully completed signed copy.

____
Signature of Borrower

I ______________________________ have fully completed the above Statement
NAME OF BROKER

in duplicate and have furnished one signed copy to the Borrower on the above date.

____
Signature of Broker

APPENDIX 3

Bank Act, Cost of Borrowing Disclosure Regulations, Schedule II, S.O.R./83-103

SCHEDULE II
STATEMENT OF DISCLOSURE
(Bank Act, section 202)
(Quebec Savings Banks Act, section 80)

Date: ________________________________
(date on which the statement of disclosure is made)

____
(name of bank)

Address: ________________________________
(address of bank)

____
(name of borrower(s))

Property on which there will be a mortgage or hypothec (address and description of buildings)________________________________

1. Principal amount of the________________________________
(1st, 2nd, 3rd)
mortgage or hypothec to be repaid by the borrower $__________
2. Deduct charges, fees, etc. where applicable. (This amount must equal the total of the amounts under section 9.) $__________
3. Amount of money to be paid to the borrower or to be disbursed on his direction is $__________
4. The annual percentage rate of the mortgage or hypothec of $__________ will be __________%* or, where the annual percentage rate is subject to variations, the initial annual percentage rate will be __________%*.
5. The principal amount and the cost of borrowing based on the annual percentage rate disclosed in section 4 will be payable in __________ payments of $__________.
period
6. Based on the annual percentage rate disclosed in section 4, the mortgage or hypothec will become due and payable in __________ years at which time the borrower, if all payments have been made on the due date, will owe $__________.
7. The term of mortgage or hypothec: __________ months. Amortization period of mortgage or hypothec: __________ years.
8. Where the term of the mortgage or hypothec is subject to variations, it shall vary in the following manner:

____
____
____

9. The charges, fees, etc. under section 2 are made up as follows:

Mortgage or Hypothec Insurance Fees	$__________	
Inspection and Appraisal Fees	$__________	
Legal Fees and Estimated Disbursements of not more than	$__________	
Other Charges	$__________	
TOTAL as shown in section 2	$__________	$__________

---

*Accurate to within 1/8th of 1%.

10. Where the annual percentage rate is subject to variations, it shall vary in the following manner, based on the following conditions: ____________________

____

____

____

11. The terms and conditions of repayment before maturity of the loan contract are as follows: ____________________

____

____

____

12. Where the mortgage or hypothec is not repaid at maturity or a payment is not made when due, the following charges may be imposed: ____________________

____

____

____

13. The first payment is due on ______________________________ 19____ .

____
(signature on behalf of the bank)

____
(signature of borrower(s))

APPENDIX 4

Bank of Nova Scotia Plain Language Mortgage

Fixed Rate Charge/Mortgage
(Land Titles Act and Registry Act)

Land Registration Reform Act, 1984

STANDARD CHARGE TERMS NO.8536

FIXED RATE MORTGAGE

1. DEFINITIONS

In this set of standard charge terms, **mortgage** means a Charge/Mortgage of Land (Form 2) in which the set is referred to by its filing number, any schedules attached to it and this set of standard charge terms. **You** and **your** mean each person who signs the mortgage as chargor. **We, our** and **us** mean Scotia Mortgage Corporation, the chargee. **Your property** means the land described in box 5, all buildings now or later on it and anything now or later attached or fixed to the buildings or the land, including additions, alterations and improvements. **Principal amount** means the amount specified in box 4. **Loan amount** means the outstanding balance of all amounts (including interest) owing to us from time to time under the mortgage, as amended from time to time.

Any reference to a box in this set of standard charge terms refers to a box on Form 2 (including anything set out in a schedule to Form 2 which deals with the subject matter of that box) and any reference to signing the mortgage means signing Form 2 or a schedule to it. References to paragraphs refer to paragraphs of this set of standard charge terms.

2. WHAT THE MORTGAGE DOES

In return for our making a loan to you in the principal amount (which, by signing the mortgage, you acknowledge having received from us), you:

(i) If you are the owner of your property, charge your property to us and our successors and assigns (called our **legal representatives**);

or

(ii) If you are a tenant of your property under a lease, charge your interest in your property (including any option to purchase) to us and our legal representatives, for the entire term of the lease

as security for repayment of the loan amount and the performance of all of your other obligations under the mortgage. This means you charge your entire interest in your property to us and to anyone to whom the mortgage is transferred in any way.

Termination of the Mortgage

Our interest in your property terminates when you have:

- Repaid the loan amount (including interest) as provided in the mortgage, and
- Complied with all of your other obligations under the mortgage.

3. INTEREST

A. Interest Rate

The interest rate payable by you on the loan amount is specified in box 9(b). Interest is payable monthly and calculated half yearly not in advance. The first half yearly calculation of interest after the **interest adjustment date** (which is one month before the date on which your first regular monthly loan payment is due) specified in box 9(d) shall be for the six month period commencing on that date. That calculation shall be made six months after the interest adjustment date and half yearly calculations of interest shall continue to be made every six months after that. Interest is payable on the loan amount at this rate both before and after the final payment date as well as both before and after default and judgment, until the loan amount has been paid in full.

B. Compound Interest

If on any monthly loan payment date you do not make the payment due on that day, we will charge you interest on any overdue portion of the loan amount (including interest) until paid to us. This is called **compound interest**. Compound interest shall be paid on your monthly loan payment dates. We will also charge interest, at the rate payable on the loan amount, on compound interest that is overdue until paid to us, both before and after the final payment date as well as both before and after default and judgment.

4. HOW YOU WILL REPAY YOUR LOAN

A. Currency and Place of Payment

You shall pay the loan amount to us in Canadian dollars. Your regular monthly loan payments and all other payments will be made at the Branch address set out in box 15, or at any other place we may designate, and are payable as follows:

B. Interest Payable Prior to and on Interest Adjustment Date

Before your regular monthly loan payments begin you will pay us interest, at the rate payable on the loan amount, on all money we have advanced to you up to the interest adjustment date or, at our option, such interest will be deducted from subsequent advances. Interest will be computed from the date of each advance and will become due and payable in monthly instalments on the first day of the month next following the date of each advance and on the first day of each and every month thereafter. The balance, if any, of interest on such advances (computed by excluding the interest adjustment date from the calculation) shall become due and be paid on the interest adjustment date.

C **Payments after the Interest Adjustment Date**

The principal amount, together with interest calculated from the interest adjustment date, shall become due and be paid by you in regular **monthly loan payments**.

You will make your regular monthly loan payments to us in equal instalments in the amount specified in box 9(h) beginning on the date specified in box 9(f) and continuing on the **FIRST** day of each and every following month and ending on the date specified in box 9(g). Each date that you are required to make a monthly loan payment is called a **monthly loan payment date**. Each monthly loan payment consists of a portion of the principal amount together with the interest due and payable on the monthly loan payment date.

You will pay the balance of the principal amount, together with all interest due and payable on it, on the date specified in box 9(i) (which is the same as the date specified in box 9(g) and is called the **last payment date**).

The principal amount is stated in box 4 and interest is payable on it at the same rate and calculated in the same manner as interest is payable on the loan amount.

D **Application of Monthly Loan Payments**

Each monthly loan payment will be used, **first**, to pay interest due and payable and **next**, to reduce the principal amount.

E **Prepayments**

You may prepay the principal amount only in accordance with the prepayment provisions, if any, set out in a schedule attached to Form 2.

5. YOUR TITLE TO YOUR PROPERTY

A **As Owner of Your Property**, you certify that:

(i) You are the lawful owner of your property.

(ii) You have the right to give us the mortgage.

(iii) There are no encumbrances on the title to your property, and

(iv) There are no limitations or restrictions on your title to your property except building by-laws, zoning regulations and registered restrictions.

This paragraph A applies unless you have advised us in writing that you are a tenant of your property under a lease, in which case paragraph B applies.

B **If you Are a Tenant of Your Property**,

(i) You certify that:

(a) The property is leased to you and your legal or personal representatives under a lease, a copy of which you have provided to us.

(b) The lease is a binding and existing lease and all information you have provided to us concerning it is true.

(c) All rents payable under the lease have been paid to the date you sign the mortgage.

(d) You have permission or the right to assign and mortgage or charge the lease, and

(e) Except as expressed in the lease, there are no limitations, restrictions or encumbrances on your interest under the lease other than building by-laws, zoning regulations and registered restrictions.

(ii) You promise:

(a) To pay the rent as it falls due.

(b) To comply with all of the other terms of the lease and not to do anything that would cause the lease to be terminated.

(c) Not to surrender the lease.

(d) Not to make any change in the lease without first obtaining our written consent.

(e) To give us a true copy of any notice or request you receive concerning the lease, and

(f) To notify us immediately if your landlord advises you of early termination or takes any steps to effect early termination of the lease.

C You will not do anything that will interfere with our interest in your property.

D In order to ensure that your entire interest in your property is charged to us you will sign any other documents or do anything further that we think is necessary.

6. USE OF YOUR PROPERTY

You will not make any additions, alterations or improvements to your property or use your property for any business purposes without our prior written consent.

7. WE ARE UNDER NO OBLIGATION TO MAKE ADVANCES TO YOU UNDER THE MORTGAGE

If we decide, for any reason, that we do not wish to advance the entire principal amount or any part of it to you then we do not have to do so, even though the mortgage is prepared, signed or registered, and whether or not any part of the principal amount has already been advanced. However, by signing the mortgage you charge all of your interest in your property to us. You will reimburse us, on demand, for all our expenses of investigating the title to your property and preparing and registering the mortgage.

8. TAXES

A You will make **monthly tax payments** to us on account of property taxes on each monthly loan payment. The amount of each monthly tax payment will be 1/12th of our estimate of a year's taxes on your property next becoming due and payable and may change from time to time to reflect changes in the annual taxes on your property. The monthly tax payments should enable us to pay all property taxes on or before their annual due date. Or, if your property taxes are payable in instalments, the monthly payments should enable us to pay the full year's instalments of property taxes on or before the date on which the first instalment is due.

B If, however, the annual due date or the first instalment date for the payment of your property taxes is less than one year from the interest adjustment date, you will pay us equal monthly tax payments during that period and during the next 12 months. These equal monthly tax payments will be based on our estimate of the total taxes payable for both periods so that we will receive enough money from you to pay all taxes for both of those periods.

C You will also pay us, on demand, any amount by which the actual taxes on your property exceed our estimate of your taxes. Or, at our option, we may increase the monthly payment to cover this amount.

D We will pay your taxes from the monthly payment we receive from you as long as you are not in default under the mortgage. We are not obliged to make tax payments on the dates they are due or more often than once a year. If you have not paid us enough for taxes, we may still pay the taxes. This will create a debit balance in your tax account. Any debit balance is immediately payable by you. We are under no obligation to advise you that a debit balance has been created.

E We will pay you interest on any credit balance in your tax account. The interest we pay will not be less than that paid by The Bank of Nova Scotia on savings chequing accounts with the same credit balance. We will charge you interest on the debit balance in your tax account at the interest rate payable on the loan amount until the debit balance is paid to us in full.

F If you fail to pay us any amount when it is due, we may apply the money in your tax account towards payment of such amount.

G We can deduct from the total final advance of the principal amount enough money to pay all taxes due on or before the interest adjustment date and which have not been paid on the date the final advance is made.

H You will immediately send us all assessment notices, tax bills or tax notices which you receive.

9. PAYMENTS WE CAN MAKE

We can pay off any liens, claims or encumbrances against your property which we consider to have priority over the mortgage. We can also pay all our expenses of collecting any payments not received from you when due. These expenses will include all our legal expenses on a solicitor and own client basis. You must immediately reimburse us for any amount so paid.

If we pay off any liens, claims or emcumbrances against your property, we will be entitled to all the rights, equities and securities of the person, company, corporation or Government so paid off. We are authorized to retain any discharge which may be given for six months or more, if we consider it advisable to do so.

10. TRANSFER OF LEASES AND RENTS

A If you have leased or, at a later date, lease all or part of your property to another person or persons, then, upon our written request, you will transfer and assign to us:

- (i) All leases, lease agreements and their renewals;
- (ii) All rents and other money payable under the terms of all leases and agreements. However, we may allow you to receive the rents so long as there is no default by you in making your payments to us or in complying with your other obligations to us under the mortgage; and
- (iii) All rights under the leases and agreements as they affect your property.

B In addition, you confirm that:

- (i) You must obtain our prior written consent for any future leases of your property or for the renewal of any lease (other than a renewal provided for in any lease);
- (ii) Nothing we do under this paragraph 10 shall put us in possession of your property;
- (iii) However, if you default under the mortgage, we have the right to take possession of your property; and
- (iv) We are not obliged to collect any rent or other income from your property nor to comply with any term of any lease or agreement.

11. INSURANCE

You will without delay insure, and keep insured, in our favour and until the mortgage is discharged, all buildings covered by the mortgage against loss or damage by fire and other perils usually covered in fire insurance policies and against any other perils we request. Such insurance must be provided by a company approved by us for the replacement cost of the buildings (the maximum amount for which the buildings can be insured) in Canadian dollars. Your policy must be in form satisfactory to us and must include extended perils coverage and a mortgage clause stating that loss is payable to us. You shall, at our request, transfer to us all insurance policies and receipts you have on the buildings and any proceeds from that insurance.

If you do not

- Maintain insurance on the buildings that, in our opinion, complies with this paragraph;
- Deliver a copy of any insurance policy or receipt to us at our request, or
- Provide us with evidence, at our request, of any renewal or replacement of the insurance, at least ten full days before your insurance expires or is terminated,

we can, but are not obliged to, insure any of the buildings. What we pay for this insurance will immediately become payable by you to us. If any loss or damage occurs, you will provide us immediately, at your expense, with all necessary proofs of claim. You will also do all necessary acts to enable us to obtain payment of insurance proceeds.

Insurance proceeds may, in whole or in part, at our option, be:

(a) Applied to rebuild or repair the damaged buildings;

(b) Paid to you;

(c) Paid to any other person who owns or did own the property, as established by the registered title, or

(d) Applied, at our sole discretion, to reduce any part of the loan amount, whether due or not yet due.

This paragraph 11 does not apply (and paragraph 20E does apply) if your property is a condominium unit.

12. KEEPING YOUR PROPERTY IN GOOD CONDITION

You shall keep your property in good condition and make any repairs needed. You shall not do anything, or let anyone else do anything, that lowers the value of your property. We can inspect your property at any reasonable time. If, in our opinion, you

- Do not keep your property in good condition, or
- Do or allow anything to be done that lowers the value of your property,

we can make any repairs we think are advisable. The costs of any inspections and any repairs we make are immediately payable by you.

13. REPAYMENT OF LOAN AMOUNT ACCELERATED

The loan amount will become payable immediately, at our option, if:

(a) You default in making any regular monthly loan payment, or any other payment you are obliged to make to us under the mortgage.

(b) You fail to comply with any of your other obligations under the mortgage.

(c) Any lien is registered against your property or we receive written notice of any lien.

(d) Your property is abandoned.

(e) Any buildings being erected or additions, alterations or improvements done on your property remain unfinished without work being done on them for 30 consecutive days.

14. APPOINTING A RECEIVER TO RECEIVE INCOME

If you default in making any regular monthly loan payment or any other payment which you have agreed to make to us, or in complying with any of your obligations under the mortgage, we can, in writing, appoint a **receiver** (which includes a receiver and manager) to collect any income from your property. We can also, in writing, appoint a new receiver in place of any receiver appointed by us. The receiver is considered to be your agent and not ours and his defaults are considered to be solely your defaults.

The receiver has the right to:

- Use any available remedy (taken in your name or our name) to collect the income from your property;
- Take possession of your property or part of it, and
- Manage your property and maintain it in good condition.

From the income collected the receiver may:

(a) Retain a commission of 5% of the total money received or any higher rate permitted by a judge or other authorized officer.

(b) Retain enough money to pay disbursements spent on collecting the income.

(c) Pay all taxes, fire insurance premiums, expenses of keeping your property in good condition, interest on those payments and all other charges that have priority over the mortgage and interest on those charges.

(d) Pay us all interest that is due and payable under the mortgage and then pay us all or part of any other amount payable under the mortgage, whether it is due or not.

Nothing done by the receiver puts us in possession of your property or makes us accountable for any money except for money actually received by us.

15. ENFORCING OUR RIGHTS

A **Default in Payment**

If you default in making any regular monthly loan payment or any other payment that you are obliged to make to us under the mortgage, we may enforce any one or more of the following remedies in any order:

(i) **Sue you** – We may take such action as is necessary to obtain payment of the loan amount.

(ii) **Foreclose or sell your property** – We may commence court proceedings to foreclose your right, title and equity of redemption to all or part of your property. If we obtain a final order of foreclosure, your property will by law become our property.

We may also ask the court to order the sale of your property. If the court makes such an order, it will supervise the sale proceedings. The net proceeds of the sale will be applied to reduce the loan amount. Any balance remaining after all claims have been satisfied will be paid to you. If the amount we receive from the sale of your property is less than the loan amount, you must pay us the difference.

(iii) **Power of sale** – If you default in making any payment for 15 days, we can on 35 days' notice to you enter on your property and:

(a) Take possession of it;

(b) Sell all or part of your property (for cash or on credit, or partly for cash and partly on credit) by private sale or public auction for the price and on those terms that can be obtained;

(c) Lease it on such terms and for whatever period we may decide upon; or

(d) Take any other remedy available to us under Ontario law.

Notice shall be given to you and to such other persons in the manner and as required by law at the time it is given. Where there are no such requirements, notice may be give to you, at our option, by one or more of the following means:

- Personal service at your last known address;
- Registered mail at your last known address;
- Publication in a newspaper published in the county or district where you property is located;
- Leaving it with a grown up person on your property; or
- Posting it on your property.

If default continues for three months, we may enter on, sell or lease your property without any notice unless notice is required by law.

We may apply the net proceeds of the sale or lease to reduce any part of the loan amount. Any balance remaining after all claims have been satisfied will be paid to you. If the amount we receive from the sale or lease of your property is less than the loan amount, you must pay us the difference.

B **Default in your obligations including default in payment** – If you default in any obligation under the mortgage (including any default referred to in paragraph A), we can enforce our above rights and we can enter on your property at any time, without the permission of any person, and make all arrangements that we consider advisable to:

- Inspect, lease, collect rents or manage your property;
- Repair or put in order any building on your property; or
- Complete the construction of any building on your property.

We can also take whatever action is necessary to take possession, recover and keep possession of your property.

C **Sale of goods** (commercial mortgage only)

If this is a commercial mortgage and you fail to make any payment to us when it is due, we can distrain against your goods. This means we can take any goods on your property and sell them as permitted by Ontario law. We may apply the net proceeds from the sale to reduce any part of the loan amount. Taking this action does not put us in possession of your property nor make us accountable for any money except the money we actually receive.

D **You will not interfere** – You will not interfere with our possession of your property (if we go into possession of your property in enforcing our above rights) nor with the possession of anyone to whom your property is sold or leased by us or any receiver. You agree not to make any claim concerning the sale or lease of your property against anyone who buys or leases it from us or any receiver, or anyone who buys or leases it after that time.

E **Our expenses** – You will immediately pay all our expenses of enforcing our rights. Our expenses include our costs of taking or keeping possession or your property, an allowance for the time and services of Scotia Mortgage Corporation's and/or The Bank of Nova Scotia's employees utilized in so doing, our legal fees on a solicitor and own client basis and all other costs related to protecting our interest under the mortgage.

F **Judgments** – If we obtain a court judgment against you for your failure to comply with any of your obligations to us under the mortgage, the judgment will not result in a merger of the terms of the judgment with our other remedies or rights to enforce your other obligations under the mortgage. We will continue to be entitled to receive interest on the loan amount at the rate payable on the loan amount and at the same times as provided for in the mortgage. The rate of interest payable on any judgment shall be calculated and payable in the same way as interest is calculated under the mortgage and at the same rate that interest is payable on the loan amount until the judgment has been paid in full.

16. DELAY IN ENFORCEMENT OF OUR RIGHTS

No delay or extension of time granted by us to you or any other person in exercising the enforcement of any of our rights under the mortgage nor any agreement referred to in paragraph 19 shall affect our rights to:

(a) Receive all payments you are obliged to make to us, when they are due and payable.

(b) Demand that you repay the loan amount and all interest which is due and payable, on any default by you.

(c) Have you comply with all of your obligations to us under the mortgage.

(d) Have any other person comply with the obligations that person has to us under the mortgage.

17. BUILDING MORTGAGE TERMS

An **improvement** means any alteration, addition or repair to any building on your property or any construction, erection or installation on your property. If the purpose of the mortgage is to finance an improvement, you must so inform us in writing immediately and before any advances are made under the mortgage. You must also provide us immediately with copies of all contracts and subcontracts relating to the improvement and any amendments to them. You agree that any improvement shall be made only according to contracts, plans and specifications approved in writing by us in advance. You must complete all such buildings or improvements as quickly as possible and provide us with proof of payment of all contracts from time to time as we require. We will make advances (part payments of the principal amount) to you based on the progress of the improvement, until either completion and occupation or sale of your property. We will determine whether or not any advances will be made and when they will be made. Whatever the purpose of the mortgage may be, we may in our sole and absolute discretion hold back funds from advances until we are satisfied that you have complied with the holdback provisions of the Construction Lien Act as amended or re-enacted. You authorize us to provide information about the mortgage to any person claiming a construction lien on your property.

18. RELEASING YOUR PROPERTY FROM THE MORTGAGE

We may establish the terms for releasing our interest in all or part of your property (that is, we may discharge, or partially discharge, your property) from the mortgage whether we receive value for our release or not. If we release part of your property from the mortgage at any time, the rest of your property will continue to secure the loan amount. We are only accountable for money actually received by us.

If your property is subdivided before our interest in your property comes to an end, the mortgage will be secured by each part into which your property is subdivided. This means that each part will secure repayment of the total amount you owe us, even if we release another part of your property from the mortgage.

We can release you, any guarantor, or any other person from performing any obligation contained in the mortgage or any other security document, without releasing any part of your property secured by the mortgage or any other security, and any such release shall not release any other person from the obligations in the mortgage.

19. RENEWING OR OTHERWISE AMENDING THE MORTGAGE

We may from time to time enter into one or more written agreements with you (or with any one to whom your property is transferred) to amend the mortgage by extending the time for payment, changing the interest rate payable under the mortgage or otherwise altering the provisions of the mortgage. Whether or not there are any encumbrances on your property in addition to the mortgage at the time the agreement is entered into, it will not be necessary to register the agreement on title in order to retain priority for the mortgage, as amended, over any instrument registered after the mortgage. Any reference in this set of standard charge terms to the mortgage means the mortgage as amended by any such agreement or agreements.

20. CONDOMINIUM PROVISIONS

If your property is a condominium unit, you are also to comply with the provisions in this paragraph 20 in addition to all of the other provisions of the mortgage (except paragraph 11).

In this paragraph 20, the Condominium Act, as amended or re-enacted, is called the **Act**. Expressions used below which are the same as those in the Act have the same meaning as those in the Act, except that the expression **condominium property** has the same meaning as the word "property" in the Act.

A. You will comply with the Act, and with the declaration, by-laws and rules of the condominium corporation (**the corporation**) relating to your property and provide us with proof of your compliance from time to time as we may request.

B. You will pay the common expenses for your property to the corporation on the due dates. Or, if we exercise our right to collect your contribution towards the common expenses from you, you will pay the same to us upon being so notified. We can accept a statement which appears to be issued by the corporation as conclusive evidence for the purpose of establishing the amounts of the common expenses and the dates those amounts are due.

C. You will forward to us any notices, assessments, by-laws, rules and financial statements of the corporation you receive (or are entitled to receive) from the corporation.

D. You will maintain all improvements made to your unit and repair them after damage.

E. **Insurance** – In addition to the insurance which the corporation must obtain, you must:

(i) Insure all improvements which you or previous owners have made to your unit;

(ii) Obtain insurance for those additional risks that we require;

(iii) Insure your common or other interest in buildings which are part of the condominium property or assets of the corporation if the corporation fails to insure the buildings or assets as required or if we require you to do so;

(iv) Assign your insurance policies to us and (as far as permitted by law) your interest in the policies held by the corporation;

(v) Provide us with proof that the required insurance is in force, if we ask for it;

(vi) Do all that is necessary to collect insurance proceeds.

Each of your insurance policies (and those of the corporation) must comply with the following:

- Your property must be covered against destruction or damage by fire and other perils usually covered in fire insurance policies and against any other perils we require for its full replacement cost (the maximum amount for which it can be insured) in Canadian dollars;
- The insurance company and the terms of the policy must be satisfactory to us.

If you fail to insure your property as required in this paragraph 20, we can, but are not obliged to, obtain any insurance which you are required to obtain. What we pay for this insurance will immediately become payable by you to us. If any loss or damage occurs, you will provide us immediately, at your expense, with all necessary proofs of claim. You will also do all necessary acts to enable us to obtain payment of insurance proceeds.

To the extent permitted by law, insurance proceeds may, in whole or in part, at our option be:

(a) Applied to rebuild or repair the damage to your property;

(b) Paid to you;

(c) Paid to any other person who owns or did own the property, as established by the registered title; or

(d) Applied, at our sole discretion, to reduce any part the loan amount, whether due or nor yet due.

F. **You must pay certain other expenses** – In addition to our other rights and remedies contained in the mortgage, you will pay us immediately all our expenses in relation to:

- Any by-law, resolution, rule or other matter (other than one for which only a vote of the majority present at the meeting is required);
- The enforcement of our right to have the corporation or any owner comply with the Act, declaration, by-laws and rules; and
- Our exercising any voting rights we may have.

Where our expenses relate to other units as well as to your property, the amount you are required to pay will only be the expenses related to your property as we determine.

G. **Voting and other rights** – You authorize us to exercise your rights under the Act to vote, consent and dissent. You also authorize us to exercise your rights to:

- Demand the corporation purchase your unit and common interest, where provided under the Act;
- Elect to have the value of your unit and common interest or that of the condominium property determined by arbitration;
- Receive your share of the corporation's assets and the proceeds from the sale of your unit and common interest or of the condominium property or any part of the common elements.

If we do not exercise your rights, you may do so according to any instructions we may give you. Before making such a demand or election you must obtain our prior written approval. You must do this even if we do not have the right to make the demand or election as between ourselves and the corporation, and even if we had previously arranged for you to exercise that right.

Nothing done under this paragraph 20 puts us in possession of your property. We are not liable for any action we may take in doing what you have authorized us to do or for any failure to act. We may at any time revoke any arrangement we make for you to do anything you have authorized us to do.

H. **Our additional rights under the mortgage** – You authorize us to do the following:

(i) Inspect your property at any reasonable time;

(ii) Do any needed maintenance or repairs after damage;

(iii) Inspect the corporation's records;

(iv) Remedy any failure of yours to comply with the Act or the declaration, by-laws and rules of the corporation.

I **Repayment of the loan amount may be accelerated** - The loan amount will become payable immediately, at our option, if:

(i) The corporation fails to comply with the Act and the declaration, by-laws and rules of the corporation;

(ii) The corporation fails to:

- insure all the condominium units and common elements according to law and according to any additional requirements of ours;
- insure its assets if we so require and according to our requirements;
- provide us with proof that the insurance is in force, if we ask for it, or
- do all that is necessary to collect insurance proceeds;

(iii) The corporation does not, in our opinion, manage the condominium property and assets in a careful way;

(iv) The corporation fails to keep the corporation's assets in good repair and working order;

(v) The corporation makes any substantial modification to the common elements or the corporation's assets without our approval;

(vi) There has been substantial damage and the owners have voted for termination of the condominium;

(vii) A sale of the condominium property or any part of the common elements is authorized;

(viii) A court makes an order that the government of the condominium property by the Act be terminated, or

(ix) The condominium property ceases to be governed by the Act.

Our rights will not be affected by the fact that we voted for or consented to such termination, sale or order or to the condominium property not being governed by the Act.

J **Termination of the corporation** - If your property ceases to be governed by the Act:

- All the terms of the mortgage continue to apply;
- You authorize us to agree with anyone to a partition of the condominium property. We can pay or receive money to ensure that the partition is equal and you will reimburse us, immediately, for any money we have paid. We can also execute all documents and do all acts needed to carry out the partition;
- Your share of the corporation's assets and the proceeds from the sale of your unit and common interest or of the condominium property or any part of the common elements shall be paid to us (unless we notify you to the contrary in writing) and you will do all things necessary to accomplish this; and
- Any money received by us (after payment of all our expenses) may be applied to reduce any part of the loan amount. Any balance remaining after all claims have been satisfied will be paid to you.

21. DISCHARGE

When our interest in your property comes to an end, we will prepare for you a full discharge of our claim (which is called a Discharge of Charge/Mortgage) or, if requested by you, an assignment of the mortgage. You will give us a reasonable time in which to prepare and sign either the discharge or the assignment and you will pay our usual administrative fee for preparing, reviewing or signing either document and all legal and other expenses we incur in so doing. You will be responsible for registering and for the costs of registering any discharge or assignment.

22. HEADINGS

Headings form no part of the mortgage. They are used so that parts of the mortgage can easily be referred to.

23. WHO IS BOUND BY THE MORTGAGE

You agree to observe and be bound by all of the terms and obligations contained in the mortgage. The mortgage will also be binding on your legal or personal representatives, our legal representatives and anyone else to whom your property is transferred. As well, the mortgage will be binding on anyone to whom it is transferred by us. All persons who sign the mortgage as chargors are collectively and individually (that is, jointly and severally) bound to comply with all obligations under the mortgage.

24. STATUTORY COVENANTS EXCLUDED

The covenants set out in Section 7(1) of the Land Registration Reform Act, 1984, as amended or re-enacted, are excluded from the mortgage.

25. GUARANTEE

In this paragraph 25, **guarantor** means each person who signs the mortgage as guarantor. **Chargor** means the person or persons who sign the mortgage as chargor and **property** means the property charged by the mortgage.

In return for us making a loan to the chargor, the guarantor, by signing the mortgage, guarantees the chargor's payments (including interest, whether or not the interest rate is changed) and compliance with the chargor's other obligations under the mortgage. Each guarantor agrees that, if the chargor defaults in making any payment or in performing any other obligation under the mortgage, the guarantor will pay us all of the unpaid payments and comply with all of the obligations which have not been complied with by the chargor. Each guarantor will be collectively and individually (that is, jointly and severally) responsible with the chargor and with one another (if more than one) for all obligations under the mortgage.

It is understood that we can:

Grant any extensions of time for payment;

Increase the rate of interest payable under the mortgage;

Release the whole or any part of the property from the mortgage or any other security;

Otherwise deal with the chargor, any other person (including any guarantor), any security (including the mortgage) or the property,

either before or after requiring payment from any person without affecting the guarantee. We may require payment from any guarantor without first trying to collect from the chargor or any other person (including any guarantor) or on any security (including the mortgage). Each guarantor's obligations shall be binding upon the guarantor's successors or personal representatives.

APPENDIX 5

"Simplified Mortgage" Form as Recommended by the Manitoba Law Reform Commission

MORTGAGE

"THE REAL PROPERTY ACT"

THE MORTGAGE ACT PROVIDES THAT THE MORTGAGOR CAN OBTAIN FREE OF CHARGE, FROM THE MORTGAGEE A STATEMENT OF THE DEBTS SECURED BY THIS MORTGAGE ONCE EVERY TWELVE MONTHS, OR AS NEEDED FOR PAYOFF OR SALE

Borrower

I, [borrower's name]
the borrower (mortgagor), being (entitled to be) registered as owner of an estate in fee simple in possession ,
subject to the encumbrances, liens and interests as are notified by memorandum underwritten or endorsed hereon in all the land described as follows:

Mortgaged Property

(called the "mortgaged property")
in return for and on receipt of the sum of DOLLARS (called the "principal sum") lent to me by you [lender's name] , the lender (mortgagee), agree to mortgage to you all my estate and interest in the mortgaged property and for better securing to you the lender the repayment in the manner following of the principal and interest and other charges and money hereby secured I, the borrower, hereby mortgage to you, the lender, all my estate and interest in the above lands and covenant with you as follows:

Payment

1. I shall pay to you in Canadian currency the principal sum and interest thereon (together called the "mortgage money") at your head office or such other place as you may designate in writing. The principal sum hereby is the sum of DOLLARS and the rate of interest chargeable thereon is per centum (%) calculated and compounded half-yearly on the day of , and on the day of , not in advance, before and after maturity of this mortgage until paid, as follows:

(a) Interest at the mortgage interest rate on the amounts advanced, computed from the respective dates of such advances, shall be due and be paid within one month of the date of the first advance and at following monthly intervals. In addition, at your option, such interest may be deducted from each subsequent advance, and the balance, if any, of the interest on advances shall be due and be paid on the day of 19 , (called the "interest adjustment date").

(b) After the interest adjustment date, the mortgage money at the mortgage interest rate computed from the interest adjustment date shall be paid as follows: by equal monthly instalments of $ each (which includes principal and interest) on the day of every month in each year beginning the day of , 19 , and ending the day of , 19
The balance, if any, of the mortgage money shall be due and be paid on the date last mentioned. These monthly instalments are to be applied first on account of interest on principal, secondly on account of interest on unpaid interest, and thirdly on account of principal.

[*Insert other payment option clauses when applicable*]

Pre-payment privileges

2. (a) If I am not in default under this mortgage, I shall have the privilege of making the following additional payments:

[*Insert appropriate pre-payment privileges*]

(b) I agree that, when any additional principal payment is made, I shall continue to pay the current monthly instalments (although such monthly instalments may require adjustment where other methods of payment apply) [*strike if inapplicable*].

Interest

3. All interest payable under this mortgage shall be calculated on the interest adjustment date, and, after that, half-yearly on the day of , and on the day of , and shall be payable monthly and be a charge on the mortgaged property. I shall pay interest at the mortgage interest rate from day to day on any money unpaid under this mortgage. If I do not pay the interest when due, it shall be added to the principal and bear compound interest at the mortgage interest rate before and after maturity of this mortgage.

Building loan

Optional

4. (a) If the loan secured by this mortgage is a building loan, I shall construct a building or buildings and other improvements on the mortgaged property in accordance with plans and specifications which have been or shall be approved by Canada Mortgage and Housing Corporation and by you. I shall carry on diligently to complete construction of the building or buildings and other improvements.

(b) It is the intention of all parties to this mortgage that the building now erected, being erected or to be erected on the mortgaged property forms part of the security for the full

Optional

amount of the money secured by this mortgage. Advances on this mortgage are to be made from time to time in accordance with the progress of the building and/or upon its completion and occupation or sale. Neither the execution nor registration of this mortgage nor the advance of part of the money shall bind you to advance the money or any part of it, it being understood that any advance in whole or in part is in your sole discretion.

Taxes and encumbrances

5. As provided in this clause, I shall pay, when due, all taxes, rates, liens, charges, encumbrances or claims which are or may become due against the mortgaged property or on this mortgage or on you in respect of this mortgage.

But with respect to municipal, school and local improvement taxes (called "taxes") chargeable against the mortgaged property:

(a) you may deduct from the final advance an amount sufficient to pay any unpaid taxes which have become or will become payable on or before the day preceding the interest adjustment date;

(b) after the interest adjustment date I shall pay to you in monthly instalments, on the dates on which instalments of principal and interest are payable, sufficient sums, as reasonably estimated by you, to pay all taxes on or before their due date. I shall also pay to you on demand the amount, if any, by which the actual taxes exceed such estimated amount.

(c) You shall allow me credit for interest at not less than the current rate paid by chartered banks on personal savings deposits with chequing privileges, on the minimum monthly credit balances in the mortgage account for payment of taxes. This interest shall be credited to the mortgage account at least once a year. I shall pay interest, at the mortgage interest rate, on any deficiency in tax payments until the deficiency is fully repaid.

You agree to apply such deduction and payments towards the taxes chargeable against the mortgaged property so long as I am not in default under any provision of this mortgage, but nothing in this mortgage shall obligate you to apply such deduction and payments more often than yearly. You may use these deductions, if not previously applied to the taxes, to pay any principal and/or interest in default. I covenant to forward to you the assessment notices (if required), tax bills and other notices affecting the imposition of taxes immediately after they are received by me.

Direct payment of taxes

6. Notwithstanding the provisions of clause 5, you may require that I pay the taxes when due and submit to you receipts for them within 30 days after they become due. The monthly instalment, where necessary, will be adjusted accordingly.

Insurance

7. (a) I shall insure and maintain insurance on all buildings and other improvements on and being constructed on the mortgaged property with a company approved by you until this mortgage is fully repaid. This insurance shall be for the full replacement value of the buildings and other improvements and shall cover loss or damage by fire and such other perils, risks or events as you may at any time require.

(b) I shall deliver to you all policies of insurance and receipts for payments of premiums or, if acceptable to you, certified copies of these policies and receipts.

(c) All these insurance policies shall insure the interests of and name as insured both you and me with loss payable first to you under a mortgage endorsement clause. Subject to the Law of Property Act and the Mortgage Act, I shall do everything that is necessary to enable you to obtain payment of any insurance proceeds. You may use these proceeds in any one or more of the following ways and in any proportion you desire:

(i) towards payment of the mortgage debt whether due or not;

(ii) to pay me;

(iii) to rebuild or repair the mortgaged property.

(d) If I fail to insure and maintain the required insurance or if I fail to carry out any of my other obligations under clause 7, you shall be entitled to insure instead of me and the cost shall be payable by me as part of the "mortgage money".

Buildings, improvements and fixtures

8. (a) All buildings and other improvements, including fixtures and appurtenances (which include built-in appliances such as stoves and washers and are deemed to be fixtures) now on or later located upon the mortgaged property shall form part of the mortgaged property and mortgage security.

Duty to keep property in good repair

(b) (i) I will not commit or permit any act of waste on the mortgaged property.

(ii) I shall repair, maintain and restore the mortgaged property until this mortgage has been repaid in full.

(iii) Within the time set out in notice from you, I shall repair, rebuild or reinstate any loss, damage or destruction which occurs to the mortgaged property. If I fail to do so within that time, such failure shall be a breach of this mortgage and the balance owing under this mortgage shall, at your option, be due and payable immediately.

Default 9. Should I default under any covenant, either expressed or implied in this mortgage, after any of the money secured has been advanced, you (or your agent where applicable) may

(a) at my expense have that covenant performed;

(b) enter upon and inspect the mortgaged property to determine its value and condition and have a lawyer examine its title;

(c) enter upon and complete the construction of, repair or put in order any buildings or other improvements on the mortgaged property;

(d) enter upon, inspect, take care of, lease, under such terms, for such periods and at such rents as you deem proper, in whole or in part, and whether in possession or not, collect the rents and profits of the mortgaged property and manage it as you deem proper;

(e) recover by distress upon the mortgaged property or part of it, or by any other means in law available to you, any mortgage money in arrears and unpaid together with all costs and expenses incurred by you;

(f) with or without entering into possession and with or without notice, sell, transfer and convey any part of the mortgaged property on such terms as shall appear to you most advantageous and for such prices as can be reasonably obtained but you shall not be accountable for or charged with any money until actually received. This power of sale may be exercised either before or after the lease referred to in subclause (d) and may be subject to that lease;

(g) sell from time to time parts of the mortgaged property to satisfy interest or principal overdue, leaving the balance of the principal to run and be paid with interest at the mortgage interest rate. You may make any stipulations as to title or evidences or commencement of title or otherwise as you deem proper, and may buy in or rescind or vary any contract for sale. On any sale or resale, you shall not be answerable for loss occasioned. For any of these purposes, you may make and execute all agreements and assurances that you deem advisable or necessary;

(h) recover, at your option, the whole of the mortgage money owing;

(i) take advantage of any remedy available in law.

Notice 10. Any notice you must give under clause 9 may be done properly by leaving it with an adult on the mortgaged property if occupied or by securely placing it there if unoccupied, or at your option by publishing it in a newspaper published in the area where the mortgaged property is situated. Such notice is sufficient even though addressed only "To whom it may concern". However, failure to provide or publish such notice or any defect in the notice as given shall not invalidate any sale or purported sale under this mortgage, but only the vendor with respect to the sale shall be responsible for such failure or defect.

Non-merger

11. I further covenant with you as follows:

(a) The obtaining of a judgment by you on any of the covenants contained in this mortgage shall not result in a merger of these covenants.

Partial release

(b) (i) You may at any time release any part of the mortgaged property or any other security or surety for payment of all or any part of the money secured by this mortgage.

(ii) You may release me or any other person from any covenant or other liability to pay the mortgage money in whole or in part, with or without consideration for such release, and without being accountable for its value, or for any money unless actually received by you.

(iii) Notwithstanding any such release, any part of the mortgaged property, security and covenant remaining unreleased shall continue as security for the mortgage money remaining unpaid.

Time extension

(c) No extension of time given by you to me or to anybody claiming under me shall in any way affect your rights against me or any other person liable for payment of the money secured by this mortgage.

Costs and expenses

(d) The following sums are to be secured by this mortgage and shall be a charge on the mortgaged property together with interest at the mortgage interest rate:

(i) all solicitors', inspectors', valuators' and surveyors' fees and expenses for preparing and registering this mortgage, for examining the mortgaged property and its title, and for making or maintaining this mortgage as a first charge on the mortgaged property;

(ii) all amounts which you advance or incur under this mortgage as principal, insurance premiums, taxes or rates, or toward payment of prior liens, charges, encumbrances or claims charged or to be charged against the mortgaged property, on this mortgage or on you in respect of this mortgage;

(iii) all expenses incurred by you in maintaining, repairing, restoring or completing the mortgaged property;

(iv) all fees and expenses incurred by you in inspecting, leasing, managing or improving the mortgaged property, including the price or value of any goods supplied to be used on the mortgaged property;

(v) legal costs incurred by you, as between solicitor and client;

(vi) any sums expended by you in exercising, enforcing or pursuing any right, purpose or remedy under this mortgage or otherwise existing in law.

I shall pay all these sums to you on demand, or if not demanded, with the next instalment, unless provided otherwise in this mortgage. All such sums together with interest at the mortgage interest rate are included in the expression "the mortgage money".

Subrogation

(e) If you advance any money under this mortgage which is applied toward the payment of any charge or encumbrance, you shall stand in the position of and be entitled to all the rights and equities of the person so paid, whether or not such charge or encumbrance has been discharged. Your decision as to the validity or amount of any advance or disbursement made under this mortgage or of any claim paid shall be binding on me.

Lender's accounting of money received

(f) You shall not be accountable for any money receivable or collectible out of the mortgaged property or otherwise, except for money actually received. All revenue of the mortgaged property received or collected by you from anyone other than myself may, at your option, be used in maintaining, insuring or improving the mortgaged property, or in payment of taxes or other charges against the mortgaged property, or applied on the mortgage debt.

Alterations

(g) I shall not make, or permit to be made, any alterations or additions to the mortgaged property without your consent.

Use of property

(h) I hall not use the mortgaged property, or permit it to be used, for the purpose of any business, trade or manufacture of any description.

Right to inspect

(i) You or your agent (or the agent of Canada Mortgage and Housing Corporation) [*strike if inapplicable*] may, at any time, enter upon the mortgaged property to inspect both the land and buildings.

(j) Any matter in this mortgage pertaining to you shall be sufficiently dealt with or exercised if done, or subsequently ratified, by the manager, acting manager or assistant manager of any of your branch offices in Manitoba, or by your executive officer or any officer or agent appointed by you for such purpose.

Title

(k) I have or am entitled to have a good (freehold or leasehold) [*strike inappropriate term*] title to the mortgaged property.

(l) I have the right to mortgage the mortgaged property.

(m) Other than this mortgage, I have done nothing to encumber the mortgaged property.

(n) On default by me, you shall have quiet possession of the mortgaged property, subject only to the encumbrances, liens and interests listed below.

(o) I will execute such other documents pertaining to the mortgaged property as you may require.

Discharge

12. You shall have a reasonable time after payment of the mortgage money in full to provide a discharge of this mortgage, and interest at the mortgage rate shall continue and accrue until actual payment in full has been received by you. I shall pay all legal and other expenses for the preparation and execution of the discharge.

Discrimination

13. I covenant that in the selling or leasing of any house, multiple family dwelling or combination thereof purchased or constructed with money borrowed from you pursuant to the National Housing Act [*strike if inapplicable*], I will not discriminate against any person by reason of conviction for which a pardon has been granted, or of race, colour, religion, national origin, sex or marital status.

National Housing Loan Regulation

14. I acknowledge the procedure described in the National Housing Loan Regulations as the procedure to be followed in determining whether there has been a breach of the covenant contained in clause 13. [*strike if inapplicable*]

Interpretation

15. Wherever the singular or any gender is used in this mortgage the plural or any other gender is included where the fact or context so requires. In any case, where this mortgage is executed by more than one person, all its covenants shall be construed as joint and several as against all such persons. The heirs, executors, administrators, successors and assigns of any person executing this mortgage are jointly and severally bound by its covenants. Such covenants shall be in addition to those granted or implied by statute. Marginal notes contained in this document shall not be used in interpreting any of its clauses.

16. This mortgage is made pursuant to The Real Property Act and the National Housing Act. [*strike if inapplicable*].

SIGNED, SEALED & DELIVERED by me this day of A.D. 19 , at in the Province of Manitoba.

IN THE PRESENCE OF)
)
)
)
____________________________)
Witness

Encumbrances referred to:

Address of the lender:

APPENDIX 6

Draft Regulation Prescribing Mandatory Terms for Residential Land Security Agreements

LAND SECURITY ACT

O. Reg. 00/00
Residential Land Security Agreement Terms
Made — [Date]
Approved — [Date]
Filed — [Date]

REGULATION MADE UNDER THE LAND SECURITY ACT

PRESCRIBED TERMS IN RESIDENTIAL LAND SECURITY AGREEMENTS

1. The terms contained in Schedule 1 shall be set out in every residential land security agreement.

2. Where a residential land security agreement contains a "due-on-sale clause", within the meaning of the *Land Security Act*, the terms contained in Schedule 2 shall be set out in the agreement.

3. The terms in Schedules 1 and 2 shall be inserted in land security agreements under the captions to which the subject matter of each individual term relates.

4. The terms in Schedules 1 and 2 may be integrated with the provisions of the land security agreement if such integration does not contradict, obscure, or distract attention from the substance of the term.

5. The terms in Schedules 1 and 2 may be altered as necessary where the land security agreement uses pronouns or other descriptions in referring to the borrower, the lender, or the agreement.

SCHEDULE 1

Description of the Secured Property

1. The Borrower gives a security interest to the Lender in the land, buildings and fixtures described below (called the "secured property"):

The Effect of the Disclosure Statement

2. If there is a conflict between the terms of this land security agreement and the disclosure statement provided to the Borrower by the Lender under the *Land Security Act*, then the individual terms of each document most beneficial to the Borrower apply in dealings between the Borrower and the Lender.

Prepayment

3. As provided by the *Land Security Act*, the Borrower may prepay the loan. If the Borrower wishes to prepay, the Borrower shall request a statement of account for the purpose of prepayment by serving a notice in writing on the Lender in the manner set out in paragraph 25. The notice shall specify a date for prepayment, which cannot be a date more than one month from the date of the notice.

4. The Lender shall serve the statement of account on the Borrower within fifteen business days after service of the notice.

5. If the Borrower pays the amount required by the statement of account on the specified date for prepayment, the Lender shall provide discharge documents to the Borrower as set out in paragraph 6 of this land security agreement.

Discharge of the Security Agreement

6. When the Borrower has paid all amounts due to the Lender under this land security agreement and the *Land Security Act*, the Lender shall prepare a release of insurance, discharges of any collateral security, and a discharge of this agreement in registrable form (called "discharge documents") at no cost to the Borrower. The Borrower is responsible for registering the discharge documents at his or her own expense.

7. The documents referred to in paragraph 6 shall be served on the Borrower within ten business days of the date on which the Borrower is entitled to the discharge.

Insurance Proceeds

8. If insurance proceeds become payable on the secured property and the Borrower intends to repair or replace the buildings and fixtures for which the proceeds are payable, then the Lender cannot require the proceeds to be paid to him or her on account of the amounts due to the Lender under this land security agreement.

Statements of Account

9. The Lender shall provide a statement of account to the Borrower at the Borrower's request. The statement will set out in detail the status of the loan.

10. The Borrower shall request the statement of account by serving a notice in writing on the Lender in the manner set out in paragraph 25, unless the Lender waives this requirement. The notice shall specify an effective date for the statement, which cannot be a date more than one month from the date of the notice.

11. The Borrower is entitled to obtain one statement in each twelve month period during the term of the agreement at no cost to the Borrower. If the Borrower wishes to obtain additional statements, the notice under paragraph 10 shall enclose a fee, which is set under the *Land Security Act*.

12. The Lender shall serve the statement on the Borrower within fifteen business days after service of the notice.

The Importance of the *Land Security Act*

13. The rights and remedies of the Lender and the Borrower under this land security agreement are set out in the *Land Security Act* and, to a limited extent, in this agreement.

14. The Act gives certain remedies to the Borrower if the Lender does not meet his or her obligations under the Act or this land security agreement.

15. The rights and remedies given by the Act cannot be waived or varied in this land security agreement, and any term in this agreement that does so is void. The Borrower should consult the Act if in doubt about these rights and remedies.

Default

16. If the Borrower does not meet his or her obligations under this land security agreement, then the Borrower has defaulted.

Enforcing the Security Interest

17. After the Borrower's default has continued for ten or more business days, the Lender may serve a notice of default on the Borrower. The notice of default will set out in detail the rights and remedies of the Lender and the Borrower under this land security agreement and the *Land Security Act* where the Borrower has defaulted.

Possession of the Secured Property

18. Except where the Borrower abandons the secured property or allows it to deteriorate, the Borrower may remain in possession of the secured property until the end of the "waiting period", which is the later of,

(a) four months after the date of the default for which the notice of default was served on the Borrower;

(b) two months after the date that a notice of sale was served on the Borrower; and

(c) the date set out in the notice of sale.

During the waiting period the Lender may not take any steps to sell the secured property.

19. The Borrower is not required to give possession of the secured property to the Lender without an order of the Court requiring the Borrower to do so.

Sale and Proceeds

20. If the Borrower does not correct the default, then after the waiting period the Lender may obtain possession of the secured property and sell it. The proceeds of sale will be applied to pay the Lender's expenses of obtaining possession and selling the property, the interest and any other amounts owed by the Borrower to the Lender, and the loan amount.

21. If the proceeds of sale are not enough to pay all the amounts due to the Lender under this agreement, then the Borrower will be liable to the Lender for the outstanding balance.

Immediate Repayment of the Loan Amount

22. Despite any term in this land security agreement making all amounts owed by the Borrower to the Lender payable immediately on the Borrower's default, such a term is not effective if the Borrower corrects the default before the secured property is sold or his or her interest in the secured property is otherwise terminated.

Service of Notices and Other Documents

23. The Borrower's designated address is ______________________

____.

24. The Lender's designated address is ______________________

____.

25. Where a document is to be served on the Lender, it shall be sent by registered mail:

(a) to the Lender's designated address;

(b) to a branch or other office of the Lender where the Borrower normally makes payment, if the Borrower knows that the designated address is no longer valid; or

(c) to such other address of the Lender known to the Borrower, if the Borrower knows that the designated address is no longer valid.

The Borrower may instead deliver the document to the Lender personally.

26. Where a document is to be served on the Borrower, it shall be sent both by registered and prepaid first-class mail:

(a) to the Borrower's designated address;

(b) to the Borrower's last known address, if the Lender knows that the designated address is no longer valid; or

(c) to the secured property, if the Lender knows that the Borrower's designated address and last known address are no longer valid.

The Lender may instead deliver the document to the Borrower personally.

Assumption of the Borrower's Obligations

27. The Borrower may request, in the manner provided by the *Land Security Act*, that the Lender consent to the assumption of some or all the Borrower's obligations under this land security agreement by a person to whom the Borrower intends to transfer the secured property (called the "transferee").

28. The Lender is obliged to consent to the assumption referred to in paragraph 27 unless it would, on commercially reasonable grounds, materially affect the Lender's risk under this land security agreement. The *Land Security Act* contains a method for resolving disputes concerning this obligation.

29. When the secured property is transferred, the transferee becomes liable to the Lender for the obligations assumed by him or her and consented to by the Lender, and the Borrower is no longer liable for them, nor is the Guarantor, if any.

SCHEDULE 2

If the Borrower wishes to prepay the loan at the time that the secured property is to be sold in good faith to an "unrelated purchaser", within the meaning of the *Land Security Act*, the statement of account provided by the Lender will not require payment of prepayment compensation or other amounts otherwise payable under the *Land Security Act*.

APPENDIX 7

Model Plain Language
Residential Land Security Agreement

LAND SECURITY AGREEMENT

Date of this agreement: ______________________________.

1. PARTIES TO THIS AGREEMENT:

1.01 This land security agreement is made between:

(a) the Borrower: ____ ;

(b) the Borrower's Spouse: ________________________________ ;

(c) the Lender: ____ ; and

(d) the Guarantor: _______________________________________ .

2. THE SECURITY INTEREST

Description of the Secured Property

2.01 The Borrower gives a security interest to the Lender in the land, buildings and fixtures described below (called the "secured property"):

2.02 The Borrower certifies that:

(a) the Borrower is the owner of the secured property;

(b) the Borrower has the right to give a security interest in the secured property to the Lender;

(c) the secured property is not encumbered except as the records of the Land Registry Office disclose.

2.03 The Lender's security interest extends to anything that may become attached or fixed to the secured property, including additions, alterations and improvements.

Effect of Disclosure Statement

2.04 If there is a conflict between the terms of this agreement and the disclosure statement provided to the Borrower by the Lender under the *Land Security Act*, then the individual terms of each document most beneficial to the Borrower apply in dealings between the Borrower and the Lender.

3. FINANCIAL TERMS OF THE LOAN

3.01 In return for a security interest in the secured property, the Lender shall lend $ ________ Canadian to the Borrower (called the "loan amount").

Interest and Compound Interest

3.02 The Borrower shall pay interest at the rate of ________% per year, payable monthly, calculated half-yearly not in advance, on the outstanding balance of the loan amount.

3.03 If the Borrower does not make a payment on the day required under this agreement, the amount of interest included in the overdue payment, including any amount of overdue principal, will be added to the loan amount for the purpose of calculating the interest payable under paragraph 3.02. The result will be interest on the overdue payment that compounds half-yearly.

3.04 The Borrower's obligation to pay interest and compound interest continues after default and after the day that final payment is due under this agreement, until the loan amount has been paid in full.

Periodic Payments

3.05 The Borrower shall make equal payments of $________ Canadian each month, beginning on ________, 19____, and ending on ________, 19____. All amounts due to the Lender on ________, 19____, shall be paid in full on that day. Payments shall be made to the Lender at the Lender's designated address, which is set out in paragraph 10.02.

Allocation of Payments

3.06 Each payment made by the Borrower will be used:

First: to pay any interest due and payable;

Second: to repay any payments made by the Lender on the Borrower's behalf under paragraph 5.10; and

Third: to reduce the loan amount.

Prepayment

3.07 As provided by the *Land Security Act*, the Borrower may prepay the loan. If the Borrower wishes to prepay, the Borrower shall request a statement of account for the purpose of prepayment by serving a notice in writing on the Lender in the manner set out in paragraph 10.03. The notice shall specify a date for prepayment, which cannot be a date more than one month from the date of the notice.

3.08 The Lender shall serve the statement of account on the Borrower within fifteen business days after service of the notice.

3.09 If the Borrower pays the amount required by the statement of account on the specified date for prepayment, the Lender shall provide discharge documents to the Borrower as set out in paragraph 4 of this agreement.

4. DISCHARGE

4.01 When the Borrower has paid all amounts due to the Lender under this agreement and the *Land Security Act*, the Lender shall prepare a release of insurance, discharges of any collateral security, and a discharge of this agreement in registrable form (called "discharge documents") at no cost to the Borrower. The Borrower is responsible for registering the discharge documents at his or her own expense.

4.02 The documents referred to in paragraph 4.01 shall be served on the Borrower within ten business days of the date on which the Borrower is entitled to the discharge.

5. ADDITIONAL OBLIGATIONS OF THE BORROWER

Insurance

5.01 The Borrower shall insure and keep insured the buildings and fixtures covered by this land security agreement, for their replacement cost, against loss or damage:

(a) by fire or other perils usually covered in fire insurance policies; and

(b) by such other perils as the Lender requests.

The Borrower is not obliged to obtain insurance on the buildings or fixtures covered by this agreement for an amount more than their replacement cost.

5.02 The insurance policy shall be in a form, and shall be issued by an insurer, acceptable to the Lender. The policy shall name the Lender as a person to whom a loss under the policy will be payable, as the Lender's interests may appear. The Borrower shall provide the Lender with a copy of the policy or evidence of renewal or replacement of the policy at the Lender's request.

5.03 If the Borrower does not:

(a) obtain and keep insurance that complies with paragraph 5.01; or

(b) provide the Lender with a copy of the policy or evidence of renewal or replacement within ten business days of the Lender's request,

the Lender may obtain insurance on the Borrower's behalf.

Use of Insurance Proceeds

5.04 If insurance proceeds become payable on the secured property and the Borrower intends to repair or replace the buildings and fixtures for which the proceeds are payable, then the Lender cannot require the proceeds to be paid to him or her on account of the amounts due to the Lender under this agreement. The proceeds shall be paid to the Lender and held by the Lender in trust for the Borrower to be disbursed in making such repair or replacement.

Taxes and Other Charges

5.05 The Borrower shall pay property taxes, utility or other charges, liens, encumbrances, and payments required under other security agreements, on the secured property.

5.06 At the Lender's request, the Borrower shall provide receipts showing that the payments required by paragraph 5.05 have been made.

5.07 If the Borrower does not make the payments required in paragraph 5.05, the Lender may make them on the Borrower's behalf.

Maintaining the Secured Property

5.08 The Borrower shall maintain the secured property in good condition and shall not do anything that lowers the value of the secured property, or make any additions, alterations or improvements without the prior consent of the Lender.

5.09 If the Borrower does not meet his or her obligations under paragraph 5.08, the Lender may enter on the secured property and make any necessary repairs or restoration on the Borrower's behalf.

Payments Made by the Lender on the Borrower's Behalf

5.10 If the Lender has made payments on the Borrower's behalf under this agreement or the *Land Security Act*, including payments:

(i) to obtain insurance under paragraph 5.03;

(ii) of taxes and other charges under paragraph 5.07; or

(iii) to repair or restore the secured property under paragraph 5.09,

then:

(iv) the Lender may require the Borrower to reimburse immediately the Lender for the amount of such payment and the Lender's related expenses, and may take proceedings against the Borrower to recover payment; and

(v) until paid, the amount owed by the Borrower under paragraphs 5.10(i)-(iii) will be added to the loan amount and will bear interest and compound interest as provided in paragraphs 3.02 and 3.03.

6. STATEMENTS OF ACCOUNT

6.01 The Lender shall provide a statement of account to the Borrower at the Borrower's request. The statement will set out in detail the status of the loan.

6.02 The Borrower shall request the statement of account by serving a notice in writing on the Lender in the manner set out in paragraph 10.03, unless the Lender waives this requirement. The notice shall specify an effective date for the statement, which cannot be a date more than one month from the date of the notice.

6.03 The Borrower is entitled to obtain one statement in each twelve month period during the term of the agreement at no cost to the Borrower. If the Borrower wishes to obtain additional statements, the notice under paragraph 6.02 shall enclose a fee, which is set under the *Land Security Act*.

6.04 The Lender shall serve the statement on the Borrower within fifteen business days after service of the notice.

7. THE IMPORTANCE OF THE *LAND SECURITY ACT*

7.01 The rights and remedies of the Lender and the Borrower under this agreement are set out in the *Land Security Act* and, to a limited extent, in this agreement.

What Happens if the Lender Does not Meet His or Her Obligations?

7.02 The Act gives certain remedies to the Borrower if the Lender does not meet his or her obligations under the Act or this agreement.

7.03 The rights and remedies given by the Act cannot be waived or varied in this agreement, and any term in this agreement that does so is void. The Borrower should consult the Act if in doubt about these rights and remedies.

8. WHAT HAPPENS IF THE BORROWER DEFAULTS

8.01 If the Borrower does not meet his or her obligations under this agreement, including the obligations:

(a) to make a monthly payment;

(b) to comply with paragraph 5.01 respecting insurance;

(c) to comply with paragraph 5.05 respecting the payment of taxes and other charges;

(d) to comply with paragraph 5.08 respecting maintenance of the secured property; and

(e) to reimburse the Lender for payments made on the Borrower's behalf under paragraph 5.10,

then the Borrower has defaulted.

Enforcing the Lender's Security Interest

8.02 After the Borrower's default has continued for ten or more business days, the Lender may serve a notice of default on the Borrower. The notice of default will set out in detail the rights and remedies of the Lender and the Borrower under this land security agreement and the *Land Security Act* where the Borrower has defaulted.

8.03 Except where the Borrower abandons the secured property or allows it to deteriorate, the Borrower may remain in possession of the secured property until the end of the "waiting period", which is the later of:

(a) four months after the date of the default for which the notice of default was served on the Borrower;

(b) two months after the date that a notice of sale was served on the Borrower; and

(c) the date set out in the notice of sale.

During the waiting period the Lender may not take any steps to sell the secured property.

8.04 The Borrower is not required to give possession of the secured property to the Lender without an order of the Court requiring the Borrower to do so.

8.05 If the Borrower does not correct the default, then after the waiting period the Lender may obtain possession of the secured property and sell it. The proceeds of sale will be applied to pay the Lender's expenses of obtaining possession and selling the property, the interest and any other amounts owed by the Borrower to the Lender, and the loan amount.

8.06 If the proceeds of sale are not enough to pay all the amounts due to the Lender under this agreement, then the Borrower will be liable to the Lender for the outstanding balance.

Immediate Repayment of the Loan Amount

8.07 Where the Borrower has defaulted, the loan amount together with interest and any other amounts owed by the Borrower to the Lender may become immediately payable at the Lender's option.

8.08 Despite any term in this agreement making all amounts owed by the Borrower to the Lender payable immediately on the Borrower's default, such a term is not effective if the Borrower corrects the default before the secured property is sold or his or her interest in the secured property is otherwise terminated.

9. EXTENSIONS OF TIME

9.01 If either party to this agreement gives an extension of time to the other party for meeting obligations under this agreement or the *Land Security Act*, then, subject to the Act, the extension does not affect the duty of the party who receives the extension to meet his or her other obligations under this agreement or the Act.

10. SERVICE OF NOTICES AND OTHER DOCUMENTS

10.01 The Borrower's designated address is ______________________

____.

10.02 The Lender's designated address is ______________________

____.

10.03 Where a document is to be served on the Lender, it shall be sent by registered mail:

(a) to the Lender's designated address;

(b) to a branch or other office of the Lender where the Borrower normally makes payment, if the Borrower knows that the designated address is no longer valid; or

(c) to such other address of the Lender known to the Borrower, if the Borrower knows that the designated address is no longer valid.

The Borrower may instead deliver the document to the Lender personally.

10.04 Where a document is to be served on the Borrower, it shall be sent both by registered and prepaid first-class mail:

(a) to the Borrower's designated address;

(b) to the Borrower's last known address, if the Lender knows that the designated address is no longer valid; or

(c) to the secured property, if the Lender knows that the Borrower's designated address and last known address are no longer valid.

The Lender may instead deliver the document to the Borrower personally.

10.05 Service of a document by mail is effective on the fifth business day after mailing, or on the date of delivery if delivered personally.

11. WHO IS BOUND BY THIS AGREEMENT?

11.01 This agreement is binding on the Borrower, the Borrower's consenting spouse, the Lender, and the Guarantor, if any, and their successors. Where this agreement is signed by more than one person, the obligations in it are joint and several against all such persons. That is, all the obligations are owed by each person collectively and individually.

Transfer of the Secured Property

11.02 This land security agreement also binds any person to whom the Borrower transfers the secured property.

11.03 The Borrower may request, in the manner provided by the *Land Security Act*, that the Lender consent to the assumption of some or all of the Borrower's obligations under this land security agreement by a person to whom the Borrower intends to transfer the secured property (called the "transferee").

11.04 The Lender is obliged to consent to the assumption referred to in paragraph 11.03 unless it would, on commercially reasonable grounds, materially affect the Lender's risk under this land security agreement. The *Land Security Act* contains a method for resolving disputes about this obligation.

11.05 When the secured property is transferred, the transferee becomes liable to the Lender for the obligations assumed by him or her and consented to by the Lender, and the Borrower is no longer liable for them, nor is the Guarantor, if any.

The Effect of Signing this Agreement

11.06 The Borrower, the Borrower's spouse and the Guarantor who sign this agreement certify that they have read it and agree to be bound by it. They also acknowledge receiving a copy of this agreement.

	(Seal)
______________________	______________________
Witness	**Borrower**
	(Seal)
______________________	______________________
Witness	**Borrower**

Consent of the Spouse

11.07 ______________________________, spouse of the Borrower, consents to this land security agreement, and agrees that his or her interest in the secured property is subject to the security interest of the Lender.

______________________________	______________________________ (Seal)
Witness	Spouse of Borrower

12. GUARANTEE

12.01 In return for the Lender making this loan to the Borrower, the Guarantor guarantees compliance by the Borrower with his or her obligations under this agreement.

12.02 If the Borrower defaults under this agreement, the Guarantor shall correct the default by paying to the Lender all overdue payments and complying with the Borrower's other obligations under this agreement.

______________________________	______________________________ (Seal)
Witness	Guarantor